IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

ARBITRATION PETITION NO. 838 OF 2016

Bharat Kapoor and 2 Ors. .....Petitioners

V/s.

Kaizen Domestic Scheme 1 and anr. ......Respondents

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Mr. Shyam Kapadia, i/by. Mr. Anil D'souza, Advocate for the petitioners.
Mr. Sameer Pandit; i/by. Wadia Ghandy & co., Advocate for the respondents.

CORAM :- SMT. R.P. SONDURBALDOTA, J.

DATED :- 13TH OCTOBER, 2016.

P.C. :-

1). This petition filed under Section 34 of the Arbitration and conciliation Act, 1996 ("the Arbitration Act" for short) challenges the Award dated 14th January, 2016 passed by the sole Arbitrator. By the impugned Award, the petitioners have been directed to convert the respondent's preference shares into equity shares in the proportion indicated in Schedule-I and IV to the agreement between the parties to take it upto 55%. The petitioners have also been directed to pay costs of Rs.75,000/- to the respondent for one of the arbitral sittings, Rs.37,50,000/- being the fees of the arbitrator paid by the respondent and a sum of Rs.25,00,000/- as legal costs.

2). Petitioners no.1 and 2 are the promoters, shareholders and Directors of petitioner no.3 which is engaged in the business of providing pre-school and child care services. Respondent no.1 is a trust company. It is also a Venture Capital Fund registered with the Securities and Exchange Board of India and engaged in making private equity investments in Education sector in India. Respondent no.2 is a Company incorporated under the laws of Mauritius. Respondents no.1 and 2 proposed to invest in petitioner no.3, Company. For that purpose, it entered into two different share subscription agreements dated 14th June, 2012 and shareholders agreement for investing a sum of INR 14.50 crores. The Articles of Association of petitioner no.3 was amended to reflect the shareholders agreement with the respondents. Under the agreements, the investment contemplated was of one equity share to each of the respondents, 1154.12 convertible preference shares to respondent no.2 and 480601 preference shares to respondent no.1 after first closing and a total 751496 preference shares after second closing. On the date of the agreements, respondent no.2 had already cleared 240988 equity shares of petitioner no.3 by way of transfer. The agreement contemplated that, at the end of the second closing , the claimants would have 48.9% shares comprising of equity and preference in the capital of the Company. Clause-8 of the agreements provided that, the respondent shall collectively hold 38% of the paid-up capital on a fully diluted basis and further provided value adjustable mechanism by which investment made by the respondents was to be adjusted on the basis of the formula mentioned in the Clause. The Clause also provided that, in the event of actual EBITDA (Consolidated End Earnings) as defined in the agreement being negative, in the second quarter of the Financial year 2014, the adjustable investment would be adjusted upwards to make the respondents stake equivalent to 55%.

3). Pursuant to the share subscription agreement, respondent no.1 subscribed to 48063 shares and respondent no.2 to 115421 shares. As contemplated after the first closing, those shares alongwith the shares already purchased by respondent no.2 amounted to 44.5% shares of the total shareholding of the Company, though, under Clause-8, the respondents were to subscribe upto only 38% of the issued and paid-up capital on fully diluted basis and after the end of the second closure.

4). Apparently, the respondents were not satisfied with the investments and desired to transfer their shares on 2nd September, 2013 to, one BBHC Education Services Private Limited on the basis of Clause-5(2) of the shareholders agreement read with Article 11 of the Articles of Association. The petitioners however, did not permit the transfer alleging that the respondents had proposed a merger with that Company which had not come into effect for various reasons. Both the sides blamed each other for the merger not coming through. When the disputes and differences between the two sides could not be resolved, the respondent claimed additional shares on the basis of Clause-8 of the share subscription agreement to the extent of 55% besides the shares already purchased by the respondents.

5). Refusal by the petitioners to comply with Clause-8 of the share subscription agreement led to the arbitral proceedings with the appointment of arbitrator having been made, pursuant to the order dated 2nd May, 2014 passed under Section 11 of the Arbitration Act by this Court. The Arbitrator accepted the claim of the respondents and passed the Award in their favour.

6). It had been contended by the respondents before the Arbitrator that, convertible preference shares being compulsorily convertible, cannot be left unconvertible. Besides, respondent no.2 being a non-resident company, can, under the Foreign Exchange Management Act, 1999 could invest only in security which is compulsorily convertible into equity shares. Besides, the conditions for Clause-8 of the share subscription agreement being operative were fulfilled. The petitioners contested the arbitral proceedings contending that the respondents were in breach of the share subscription agreement, having failed to invest the quantum of the shares which they were obliged to do. They also alleged that, the respondents had provided confidential information to a competitor in breach of the shareholders agreement and the Articles of Association. Another contention of the petitioners was that, Clause-8 of the share subscription agreement is not enforceable because the same has not been incorporated in the shareholders agreement and under the Articles of Association. Therefore, no obligation under Section 8 could be raised. Before the Arbitral Tribunal, the parties did not lead any oral evidence.

7). Since the entire claim of the respondents arose out of Clause-8 of the share subscription agreement, it would be convenient to reproduce the same at this stage :

> "**8. VALUE ADJUSTMENT MECHANISM**
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> 8.1 It is clarified that the average pre-money valuation of the Company shall be Rs.23,25,00,000/- (Rupees Twenty Three Crores and Twenty Five Lakh only) and pursuant to the Series A Preferred issued and alloted tot he Investor 1 and Investor 2 pursuant to the Investor 1 Subscription Agreement and the Investor 2 Subscription Agreement, respectively, the Investor and Investor 2 shall collectively hold 38% (thirty eight percent) of the issued and paid up share capital of the Company on a fully diluted basis ("Total Investor Stake").
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> 8.2 Immediately following the finalization of the Accounts of the Company for the second quarter of the Financial Year 2014 commencing July 2013 and ending September 2013, the revenues of the Company shall be audited by one of the Big Four Firms or such other accounting firm acceptable to Investor 1 and Investor 2, following Indian GAAP ("Audited Accounts") and the Board shall, calculate the shareholding structure of the Company on the basis of the report prepared by such identified Big Four Firm or accounting firm acceptable to Investor 1 and Investor 2 and adjust it in accordance with the Valuation Adjustment Mechanism

provided in this Clause 8 no later than December 31, 2013.

8.3 the Adjusted Investor Stake shall be calculated in accordance with the following formula :

Adjusted Investor Stake = (Initial Stake) *[(RR * 60% + ER * 40%) ^ (PV)]

Wherein :

“Adjusted Investor Stake” means the collective stake of Investor 1 and Investor 2, on a fully diluted basis, in percentage of the equity shareholding of the Company, arrived at post the value adjustment as set out in this Clause 8.

“Initial Stake” shall mean the collective stake of Investor 1 and Investor 2 in percentage in the equity shareholding of the Company, on a fully diluted basis, pursuant to the Series A Preferred issued and alloted to the Investor 1 and Investor 2 pursuant to this Agreement and the Investor 2 Subscription Agreement, respectively and shall exclude any and all shares which are held by either Investor 1 or Investor 2 in the Company, under any other agreements. It is clarified that the Initial Stake shall be 38% (thirty eight percent) in the event of the aggregate amount invested by Investor 1 and Investor 2 being equal to the Total Investor Commitment.

“RR” means the Actual Revenue divided by the Target Revenue.

“ER” means the Actual EBITDA divided by the Target EBITDA.

“PV” means the Power Variable and the value is -1 (minus one).

"Actual Revenues" and "Actual EBITDA" means the audited actual revenues earned by the Company in the second quarter of the Financial Year 2014 (July 2013 to September 2013).

"Target Revenue" means Rs.7,57,00,000/- (Rupees Seven Crore Fifty Seven Lakh only).

"Target EBITDA" means Rs.1,72,00,000/- (Rupees One Crore Seventy Two Lakh only).

Investor 1 and Investor 2 shall be issued such number of Series A Preferred such that the aggregate percentage of equity shareholding of the Investors collectively on a fully diluted basis as determined by the number of Equity Shares represented by all Series A Preferred held by Investor 1 and all Series A Preferred held by Investor 2 all on an as converted basis (hereinafter referred to as "Investor Equity Shareholding") shall be equal to the Adjusted Investor Stake.

Provided that the downward adjustment in the Initial Stake pursuant to this Clause 8.3 shall at no time go below 33% (thirty three percent) and the upward adjustment in the Initial Stake pursuant to this Clause 8.3 shall at no time exceed 55% (fifty five percent).

It is further agreed and understood between the Parties that in the event of the Actual EBITDA of the Company being negative, the Adjusted Investor Stake shall directly be adjusted upwards to an amount equivalent to 55% (fifty five percent)."

8). The Arbitral Tribunal observed that, the Value Adjustment Mechanism had clearly come into operation on the basis of EBITDA being negative and there was no dispute that the EBITDA had become negative completely justifying the claim of the respondents. The Tribunal rejected the claim of the petitioners based on Clause-8 not being incorporated in the Articles of Association and not being included in the shareholders agreement with an observation that non-incorporation in the Articles of Association cannot be of relevance in case of adjudication of contractual rights and liabilities of the parties and that the share subscription agreement is distinct from the shareholders agreement. The shareholders agreement deals with the obligation of shareholders, *inter-se*, in relation to the shares held by them and Clause-17.5 thereof, restricts the operation to the subject matter of the shareholder agreement. It does not and cannot affect the rights of the respondents to convert further preference shares, if they are otherwise entitled to. As regards the allegation that the respondents did not subscribe to the quantum of shares originally contemplated, the Tribunal held that the same was not mandatory and if some part of the original subscription is not made, it cannot prevent the other clauses from becoming operative. It is further observed that, in any case, neither party had terminated the contract on any ground. Therefore, the obligation to act in terms thereof, had remained intact. About the contention of the petitioners as regards breaches of the agreement, the learned Arbitrator held that the same does not affect the claim of the respondents and even if the claim of the petitioners was right, the entitlement of the respondents to conversion having arisen earlier, it would be inconsequential for the present dispute.

9). The petitioners challenge the arbitral award on 17 grounds enumerated at Grounds (A) to (Q) of the petition. A substantial number of those grounds i.e. grounds other than (A) to (D) and (L) to (N) contend that the impugned award is erroneous for the reasons stated therein. Such grounds being clearly beyond the purview of Section 34 of the Arbitration Act, need not be dilated further. At Grounds (A) to (D) and (L) to (N), the petitioners have raised the contentions that had not been raised earlier. They seek to contend that, the claim of the respondents before the Arbitrator was in the nature of seeking specific performance of Clause-8 of the share subscription agreement. Therefore, the respondents had to, (i)plead and prove that they were ready and willing to perform their part of obligation under the contract, (ii) there cannot be specific performance of contract for transfer of movable property, (iii) Clause-8 of the share subscription agreement is contrary to Sections 62 and 63 of the Companies Act, (iv) in view of Section 51 of the Contract Act, if there is a reciprocal promise unless the party seeking performance respects it's obligations, it cannot compel others to perform their part of the agreement. The provisions of Clause-8 of the share subscription agreement was impossible to be performed and (v)the relief of specific performance being a discretionary and equitable relief, the discretion ought to have been exercised in favour of the petitioners.

10). Mr. Kapadia, the learned Advocate appearing for the petitioners, has made extensive submissions on the mandatory contents of pleadings in the claim for specific performance and the proof of such pleadings by making reference to the decision of the Apex Court in (i) **N.P. Thirugnanam (Dead) by Lrs V/s. Dr. R. Jagan Mohan Rao and Ors. reported in (1995) 5 SCC page 115** and unreported decision of the Apex Court in, (ii) **Union of India Versus. Ibrahim Uddin and Anr. dated 17th July, 2012** and, (iii) **Manohar Lal (D) by LRs v. Ugrasen (D) by LRs & Ors. reported in 2010 (7) SCR**.

11). Mr. Pandit, the learned Advocate appearing for the respondents submits per contra that, the contentions raised by the petitioners are clearly beyond the ambit of Section 34 of the Arbitration Act. He submits that, there is an attempt made by the petitioners to fit their arguments into the Head of the arbitral award being in conflict with the "the Public Policy of India" available under Section 34(2)(b)(ii) of the Arbitration Act. The expression "the Public Policy of India" has been the subject matter of consideration by the Apex Court in its various decisions. He refers to the decision of the Apex Court in **ONGC V/s. Saw Pipes Ltd. reported in (2003) 5 SCC page 705** by which the Apex Court held that the Award could be set aside on the ground being opposed to "the Public Policy of India" if it is contrary to (a) the 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.In my opinion, there can be no merit in the argument advanced. Firstly, none of these grounds were raised before the learned Arbitrator and the petitioner cannot be permitted to raise the same before this Court for the first time in its limited jurisdiction under Section 34 of the Arbitration Act on the spacious ground that the same are questions of law as indicated in the impugned award. The respondents had already performed their part of the contract to the extent of their demand in the claim before the learned Arbitrator. The conversion into equity shares taken out by them was restricted to the convertible preference shares held by them. The argument of share being a movable property, its specific performance cannot be ordinarily permitted, can also not be accepted since the claim of the respondents cannot be said to be specific performance for allotment of shares. Their demand is for conversion of the shares held by them as convertible preference shares into equity shares of the corresponding value. Thus, there is no merit in the petition. Hence, the petition is dismissed with costs quantified at Rs.1,00,000/- (Rs. One Lakhs only) to the respondent. The illegality must go to the root of the matter and if the illegality is of trivial nature it cannot be held that the Award is against the public policy. The 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. The term "fundamental policy of Indian Law" has been elaborated in the subsequent decision of the Apex Court in **ONGC Ltd V/s. Western Geco International reported in (2014) 9 SCC page 263**. The Apex Court elaborated on the term "Fundamental Policy of Indian Law" by referring to three distinct and fundamental juristic principles that must necessarily be understood as a part and parcel of “fundamental Policy of Indian Law”. They are (i)in every determination, the Court/ Authority/ Arbitrator must adopt “*judicial approach*”, (ii)while determining the rights and obligations of parties, there must be adherence to principles of natural justice and (iii)the decision must not only be so perverse or so irrational that, no reasonable person would have arrived at it. The latest decision on the principles governing “Fundamental Policy of India” of the Apex Court is in **Associate Builders Versus. Delhi Development Authority, reported in 2015 3 SCC page 49**. It has been held that the principles which form fundamental policy of Indian Law are that, (i) the Arbitrator must act judiciously, (ii) there must be compliance with statutes and judicial precedents, (iii) compliance with principles of natural justice and (iv) the decision must not be so perverse or so irrational that no reasonable person could have arrived at it (Wednesbury reasonableness).

12). In my opinion, there can be no merit in the argument advanced. Firstly, none of these grounds were raised before the learned Arbitrator and the petitioner cannot be permitted to raise the same before this Court for the first time in its limited jurisdiction under Section 34 of the Arbitration Act on the spacious ground that the same are questions of law. As indicated in the impugned award, the respondents had already performed their part of the contract to the extent of their demand in the claim before the learned Arbitrator. The demand for conversion into equity shares was restricted to the convertible preference shares held by them. The argument of share being a movable property, its specific performance cannot be ordinarily permitted, can also not be accepted since the claim of the respondents cannot be said to be for specific performance of contract for allotment of shares. Their demand is for conversion of the shares held by them as convertible preference shares into equity shares of the corresponding value. Thus, there is nothing in it, which can be said to be in conflict with the public policy of India. Hence, the petition is dismissed with costs quantified at Rs.1,00,000/- (Rs. One Lakh only) to the respondent.

(SMT. R. P. SONDURBALDOTA)