

(2013) 07 BOM CK 0150

In the Bombay High Court

Case No : Appeal No. 55 of 2013 in Arbitration Petition No. 1443 of 2010, Notice of Motion (L) No. 2445 of 2012 and Notice of Motion No. 1981 of 2012 in Appeal (L) No. 577 of 2012 in Arbitration Petition No. 1443 of 2010

Sportking India Limited

APPELLANT

Vs

H.D.F.C. Bank Limited

RESPONDENT

Date of Decision : 29-07-2013

Acts Referred:

Arbitration and Conciliation Act, 1996 — Section 34

Citation : (2013) 07 BOM CK 0150

Hon'ble Judges : S.C. Gupte, J;D.Y. Chandrachud, J

Bench : Division Bench

Advocate : Venkatesh Dhond, Mr. Sharan Jagtiani, Ms. Anuja Jhunjunwala and Amey Mirajkar instructed by Naik Naik and Co, for the Appellant; Zubin Behram Kamdin, Ms. Shaheen Parikh, Dharam Jumanji and Mr. Zehaan Trivedi instructed by y Amarchand and Mangaldas and S.A. Shroff and Co., for the Respondent

Final Decision : Dismissed

Judgement

D.Y. Chandrachud, J.—Admit. Learned counsel for the Respondent waives service. The appeal is taken up for hearing and final disposal, by consent and on the request of the learned counsel. The appeal arises from a judgment of a learned Single Judge dated 6 July 2012 by which a challenge to an arbitral award of a sole arbitrator u/s 34 of the Arbitration and Conciliation Act, 1996 has been rejected.

2. The Appellant and the Respondent entered into five derivative transactions. The dispute in the arbitral proceedings pertains to two transactions entered into on 2 July 2007 and 6 September 2007. Both these transactions were, according to the claimant, namely, the Respondent bank, entered into for the purposes of hedging a possible loss on account of foreign exchange fluctuations. A derivative transaction is a transaction which is based on an underlying transaction, in the present case, the underlying transaction being a transaction involving foreign

exchange. Admittedly there were three other transactions between the parties of 30 July 2007, 16 August 2007 and 5 September 2007. In consequence of those three transactions, the Appellant earned profits of USD 125,000. The claim of the Respondent before the arbitral tribunal in respect of moneys due and payable under the transactions dated 2 July 2007 and 6 September 2007 has been allowed in the following terms:

The Respondent do pay to the Claimant-HDFC the Principal sum of Rs. 5,93,53,892 together with interest of Rs. 1,23,37,967 and cost of Rs. 2,31,364.58 (if not already paid) on or before 31st December 2010 failing which it will pay interest on the principal sum of Rs. 5,93,53,892 at the rate of 8% per annum from 21st July 2010 until payment/recovery. Having regard to the total number of sittings held, I award the claimant cost of the arbitration at Rs. 10,00,000 (ten lacs only). The Respondent is given three months time to satisfy the Award, failing which it will pay interest from 21st July 2010 until payment/recovery at the rate of 8% p.a. Award accordingly.

3. The award of the arbitral tribunal was questioned before the learned Single Judge. The petition has been dismissed by the impugned judgment.

4. Four submissions have been urged during the course of hearing:

(i) Under a Master circular issued by the Reserve Bank of India on 2 February 2007, a bank which is an authorized dealer, has to be satisfied upon verification of the documentary evidence about the genuineness of the underlying exposure. In the present case, the Respondent had by an e-mail dated 20 December 2007 called upon the Appellant to furnish an underlying confirmation for the derivative deals and in response to which the Appellant sent a confirmation. Hence, it has been submitted that on the date on which the transactions were entered into, there was no confirmation by the Appellant of the underlying transaction and hence, the bank entered into a transaction without being satisfied about the genuineness of the underlying exposure. Consequently, the two derivative transactions were submitted to be void and unenforceable being in breach of the Master circular issued by the Reserve Bank of India;

(ii) The ISDA agreement on the basis of which the transactions were entered into between the Appellant and the Respondent, has not been signed by the Respondent. In the circumstances, when the agreement was not executed by the bank, it could not have entered into a derivative transaction;

(iii) The arbitral tribunal misconstrued the provisions of the Master circular by holding them to be directory insofar as the dealings inter partes are concerned;

(iv) The arbitral tribunal proceeded on the erroneous basis that the requirements of the RBI circular would not apply to foreign exchange derivatives. The case of the Appellant is that when the derivative transactions were entered into, the Respondent had concealed from the Appellant that it had entered into a mirror transaction and the transactions that were sought to be entered into with the

Appellant, were intended to pass on the risk of a currency depreciation to the Appellant.

5. Now, in considering the submissions which have been urged, it would be necessary to make a brief reference to the regulatory background though, we must clarify at the outset that this would be for the limited purpose of considering the challenge u/s 34 of the Arbitration and Conciliation Act, 1996. In these proceedings, the Court has not been called upon to render a conclusive or binding interpretation of the Master circular issued by the RBI, particularly in a proceeding where the RBI is not a party, in a matter arising out of an award of an arbitral tribunal involving an authorized dealer and its constituent.

6. The RBI issued in the year 2000 the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000. A foreign exchange derivative contract is a financial contract whose value is derived from the price movement of one or more underlying assets and includes a transaction which involves at least one foreign currency; or at least one interest rate applicable to a foreign currency or a forward contract¹. Regulation-4 allows a person resident of India to enter into a foreign exchange derivative contract in accordance with the provisions of Schedule-I to hedge an exposure to risk in respect of a transaction permissible under the Act or the Rules, regulations, directions or orders made thereunder. Schedule-I indicates, inter alia, that a person resident of India may enter into a forward contract with an authorized dealer to hedge an exposure to exchange risk in respect of a transaction for which sale and/or purchase of foreign exchange is permitted under the Act, or rules, regulations, directions or orders made or issued thereunder, subject to certain terms and conditions. Among the terms and conditions, the relevant condition is that the authorized dealer through a verification of the documentary evidence, should satisfy itself about the genuineness of the underlying exposure. Where the exact amount of the underlying transaction is not ascertainable, the contract is booked on the basis of a reasonable estimate.

7. The RBI has issued a Master circular on 2 July 2007 consolidating all its earlier instructions. The circular allows a person resident in India, to enter into a forward contract with an authorized dealer to hedge an exposure to the risk. The relevant part of the circular reads as follows:

Forward Contracts: A1. A person resident in India may enter into a forward contract with an Authorized Dealer Category-I (AD) bank in India to hedge an exposure to exchange risk in respect of a transaction for which sale and/or purchase of foreign exchange is permitted under the Act, or rules or regulations or directions or orders made or issued thereunder, subject to the following terms and conditions:

a) The AD bank through verification of documentary evidence is satisfied about the genuineness of the underlying exposure, irrespective of the transaction being a current or a capital account transaction. Full particulars of contract should be

marked on such documents under proper authentication and copies thereof retained for verification. However, AD bank may allow importers and exporters to book forward contracts on the basis of a declaration of exposure subject to the conditions mentioned in paragraph A2 of this circular.

The authorized dealer banks have been permitted to allow importers and exporters to book forward contracts on the basis of a declaration of exposure and based on past performance up to the average of the previous three financial years' turn over of imports/exports and the actual turn over of the previous year, whichever is higher, subject to various terms and conditions.

8. In the present case, the first submission in appeal is that the Respondent as an authorized dealer was bound to verify the genuineness of the underlying exposure before it entered into a derivative transaction with the Appellant. The submission proceeds on the basis that it was only after the transaction was entered into that the Appellant was called upon by the Respondent to furnish a confirmation of the original transaction. Hence, it has been asserted that the bank entered into a derivative transaction without satisfying itself of the genuineness of the underlying exposure and was in breach of the Master circular.

9. Now, at the outset it will be necessary to note that the arbitral tribunal prefaced its discussion on this aspect by adverting in a considerable amount of detail to the fact that the Appellant was dealing in import and export of the textiles and had a large turnover of exim transactions. The relevant observations in the arbitral award can be conveniently extracted for the purpose of the record:

The Respondent had banking relations with various nationalized banks, such as, SBI, PNB, SBP, including CBoP Bank now HDFC and several private Banks, such as, ICICI, Kotak Mahendra etc. Its relations with CBoP Bank dates back to 1997 and continued at the date of the transactions in 2007. It is also clear that Daljeet Singh and Jasmeet Singh, officers of the Ludhiana Branch of the SBoP bank, regularly visited the office of the Respondent in connection with the operation of its account with the branch. The Respondent was dealing in import and export of various textile materials and in textile manufacture. It is common knowledge that Ludhiana has a large hosiery/textile market. The evidence of Mr. Parveen Gupta shows that the Respondent's turnover was Rs. 171.36 crores as on 31.3.2006; Rs. 200.18 crores as on 31.3.2007 and Rs. 239.30 crores as in the year 2007-08; these figures being inclusive of exports and imports of Rs. 27.04/10.78 crores, Rs. 43.78/60.04 crores and Rs. 77.37/16.99 crores, respectively in the above years. All the major exports/imports were in USD. The turnover figures disclose a steady rise in the business. The imports in 2006 were to the tune of Rs. 60 crores and about Rs. 16 crores upto the date of the transaction in 2007.

These circumstances were indeed germane to the decision of the Bank to transact with the Appellant.

10. The sole arbitrator also took note of the fact that before the deal of 2 July 2007 was finalized, the Board of Directors of the Appellant had passed a

resolution authorizing, inter alia, its Managing Director to enter into transactions of foreign currency derivative products, amongst others. It is only thereafter that a Master agreement was executed with the Managing Director of the Appellant, which was exhibited and marked as Exhibit-C-2, on 2 July 2007. Admittedly besides the two transactions in dispute, the Appellant entered into three similar transactions on 30 July 2007, 16 August 2007 and 5 September 2007 through the Respondent where it earned a profit in the amount of USD 125,000. Faced with this admitted position, the Appellant offered before the arbitrator to return the profit to the bank. The arbitrator correctly held that this belated offer cannot have evidentiary value.

11. Now it is in this background that it is necessary to note that on 20 December 2007 an officer of the Respondent addressed an e-mail to the Appellant seeking underlying confirmation of the derivative deals in the format which was attached. The Appellant on 20 December 2007 sent a confirmation together with an e-mail as an attachment. The confirmations which were dated 2 July 2007 and 6 September 2007, it must be noted, were with reference to the specific transactions and contained a declaration that the Appellant had not entered into any hedge against the same underlying transaction with any other bank. It was in this background that the arbitrator entered a finding of fact that the confirmation which was addressed by the Appellant to the Respondent was specifically for hedge purposes.

12. The submission that the Bank had not exercised due diligence while entering into the transactions with the Appellant, in our view, cannot lie at the behest of the Appellant. Admittedly the Appellant was a party to the transactions with the bank, three of which in fact resulted in a substantial gain in the amount of USD 125,000 to the Appellant. This was retained by the Appellant and it was only when it was confronted with a loss in the two transactions in dispute that it sought to contend that the bank had not satisfied itself about the underlying exposure before it had entered into the transactions in questions. Such a submission cannot, at any rate, be heard to be urged by the Appellant. It is impossible to accept the contention of the Appellant that the transaction was void. The material before the arbitrator was sufficient to indicate that the transaction was entered into after the Appellant had furnished an authority/resolution of its board; the Appellant had dealings with several nationalized banks and the evidence indicated a substantial turn over of imports and exports. We do not find any merit in the first submission.

13. The second submission in appeal relates to the argument that the ISDA agreement was not signed and executed by the Respondent. Now, it must be noted at the outset that in paragraph 7(k) of the reply that was filed before the arbitral tribunal by the Appellant to the claim, the Appellant admitted that the ISDA Master agreement "was executed between the parties", though according to the Appellant, the agreement was undated. In paragraph 7(m), the case of the Appellant was that on 2 July 2007 the Appellant had under the advise and

instructions of the Respondent through Ms. Uma Ramchandran, Treasury Marketing Manager, M/s. Centurion Bank of Punjab Ltd. entered into a one touch option trade/transaction for a stipulated amount. The submission that the agreement had not been executed by the bank was urged before the arbitral tribunal to contend that there was no arbitration agreement between the parties. However, as the learned Single Judge noted, the contention that there was no arbitration agreement was given up before the arbitral tribunal. The learned arbitrator had also recorded a finding of fact that the ISDA Master agreement and confirmations with all details have been in fact been executed and duly signed by the officials of the Appellant. Individual confirmation contract notes for the transactions of 2 July 2007 and 6 September 2007 had also been signed and filed. Finally, it is not in dispute that the agreement which was tendered in evidence has been signed and executed by both the parties. Hence, we do not find any merit in the second submission.

14. The third and fourth submissions in regard to the construction which has been placed by the arbitrator on the Master circular of RBI cannot detain the Court in these proceedings. The arbitral tribunal has held that the requirements of the Master circular stand satisfied. Hence, for the purposes of the appeal, it is not necessary for the Court to dwell upon a wider issue of the construction of the Master circular and its applicability to foreign exchange transactions. We proceed on the basis that the Master circular does apply to the foreign transactions. Even so, the requirements of the Master Circular were fulfilled and on the facts as found by the arbitral tribunal on the basis of the evidence on record, there was nothing to indicate that the transaction was void or unenforceable.

15. Before concluding it would be necessary to note that the arbitral tribunal has extensively dealt with the evidence of the witness who deposed on behalf of the Appellant. The witness was asked during the course of the cross-examination to explain how according to him the bank had violated the Master circular of the RBI or any provision of law. The witness answered that he had learnt only on the previous day that the authorized dealer was required to verify the documents underlying the exposure along with a declaration that the underlying exposure was not hedged with any other bank and its maturity of tenure ought not to exceed the time as per the underlying exposure. The arbitrator has noted that the witness was evasive. Be that as it may, it was on the basis of a consideration of the evidence on the record that the arbitral tribunal entered the following finding:

... The Claimants did obtain the ISDA Master Agreement (Exh. C-2/C-1), the Deal Confirmations (C-2 & 4), and the Underlying Declarations (C-21 & 22, R-28). Admittedly, all these documents were executed by the Respondent's Managing Director Munish Awasthi and Mr. Parveen Gupta, after due verification. Counsel for HDFC therefore argued that the Respondent is bound by these documents and is estopped from contending otherwise. Not only that they had entered into three other similar transactions with HDFC whereunder they earned profits of

USD 125,000 from HDFC and received payments. To overcome this fact placed against them the Respondent belatedly offered that they were prepared to return the profit to HDFC. Such a belated offer can have no evidentiary value.

16. In view of the aforesaid discussion, we find that the learned Single Judge was not in error in declining to entertain the petition u/s 34 of the Arbitration and Conciliation Act, 1996. Having regard to the parameters of Section 34, it cannot be held that the award is contrary to public policy. No case for interference in appeal has been made out. The appeal shall accordingly stand dismissed. There shall be no order as to costs. In view of the dismissal of Appeal, Notice of Motion No. 1981 of 2012 in the appeal does not survive and stands disposed of as such.

1. Regulation 2(v) of Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000