INTERNATIONAL JOURNAL FOR LEGAL RESEARCH AND ANALYSIS

Open Access, Refereed JournalMulti Disciplinary
Peer Reviewed Edition :

www.ijlra.com

 ISSN: 2582-6433

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ISSN: 2582-6433

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ISSN: 2582-6433

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"UNVEILING THE DISTINCTIVE DYNAMICS OF SECURITIES ARBITRATION: A COMPREHENSIVE EXPLORATION"

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Abstract

India is receiving high levels of Foreign Portfolio Investment and Foreign Direct Investment each year, a trend that is only expected to grow further. In an emerging economy like India, securities arbitration will play the role of a vital mechanism for investor protection, market integrity, addressing disputes, fostering investor trust and attracting foreign investment. This paper explores the realm of how securities arbitration within the framework of SEBI Byelaws has been interpreted by various Indian courts. It examines the crucial and distinct provisions of the SEBI's byelaws pertaining to arbitration— a valid arbitration agreement, and interim measures in securities arbitration amongst other things, highlighting SEBI's regulatory framework as the backdrop and contributing to a comprehensive understanding of the same. This study is novel in analyzing key provisions and precedents relevant to securities arbitration, something that the existing literature has not delved into deeply.

Introduction

Securities arbitration is a resolution process of disputes arising between investors and professionals in securities industry like brokers, investment advisors and brokerage firms. Arbitration, not a novelty anymore in the Indian Scenario, is an Alternative Dispute Resolution (ADR) method involving a neutral third party— arbitrator or umpire, or a panel of the same to hear both the sides and come upon a decision that shall be binding on the both parties. Arbitration in the securities transaction disputes became common in USA in the 1980's, and the American Supreme Court upheld the enforceability of arbitration agreements to redress investor claims in *Shearson/American Express Inc v. Mcmohan*[1]. Securities arbitration is an investor friendly and

[1] 482 U.S. 220.

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credible mechanism under the SEBI regulated stock exchanges to redress stakeholder's grievances and resolve their disputes amicably.

The mechanism and procedure for such arbitral proceedings is provided by the byelaws of various stock exchanges- that are empowered under S. 9(1) r/w (2)(n) of the Securities Contracts (Regulation) Act, 1956 to notify such byelaws. Further the Securities Exchange Board of India (herein referred to as SEBI), being the apex regulator of all stock exchanges, is empowered u/s 10 of the Act to make or amend byelaws of recognized stock exchanges. The bulk of these byelaws were made by the SEBI via its various circulars that were issued time to time that later coalesced into the master circular[2] of 2010.

While there has been considerable research in the past about the desirability and suitability of arbitration in diverse areas, including securities transactions, there is not much existing literature on the judicial interpretations of its substance and procedure. Hence, this paper primarily and largely relies on past judicial precedents to build upon the subject. This paper has been divided into two parts dealing with two most distinguishable facets of securities arbitration— Part I dealing with the jurisprudence of a valid arbitration agreement, and Part II dealing with interim reliefs. There shall also be references to terms related to capital markets, since it forms the subject matter of securities transaction disputes. While the securities arbitration mechanism differs from the procedure provided under Arbitration and Conciliation Act, 1996, this paper is confined only to the substantive aspects of it, omitting a deep dive into purely procedural ones like the appointment of arbitrator, appellate tribunals, enforcement of awards etc. The term 'byelaws' has also been frequently used. As mentioned earlier, these byelaws are made by the stock exchanges u/s 9 of the Securities Contracts (Regulation) Act, 1956 and are almost identical in all SEBI recognized stock exchanges. Hence, the names of the specific stock exchanges have been omitted to avoid confusion.

[2]MASTER CIRCULAR ON ADMINISTRATION OF STOCK EXCHANGES, ARBITRATION IN RECOGNISED STOCK EXCHANGES AND STOCK EXCHANGE '(Securities Exchange Board of India, 31 December 2010), https://www.sebi.gov.in/legal/master-circulars/dec-2010/master-circular-on-administration-of-stock-exchanges-arbitration-in-recognised-stock-exchanges-and-stock-exchanges-trading-platform-for-small-and-medium-enterprises-including-guidelines-for-market-ma-_14420.html (last visited Nov 26 2023).

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Part I

What is a valid Arbitration Agreement for Securities Transaction in India?

The sine qua non of a valid arbitration agreement to be enforceable is that it must take place with the consent of the parties that are a party to the proceedings. For this purpose, S. 7 of the Arbitration Act provides that an arbitration agreement must be in writing and has to be signed by both the parties, failing which the agreement to refer the dispute to arbitration shall not be considered valid. However, the agreement in a securities transaction is in the form of a contract note. Unlike an arbitration agreement u/s 7 of the Arbitration Act, an agreement under the byelaws and regulations pertaining to arbitration, is a part of the contract notes drafted. A contract note is a formal and legal record of a transaction that may have taken place in a stock exchange by availing the services of a stockbroker. A contract note describes key details of a particular transaction together with date, time, price, quantity traded etc. and most importantly the byelaws and regulations pertaining to Arbitration.[3] Since the signature of both the parties is not essential for a contract note to be valid as per the byelaws of most stock exchanges[4], therefore, it follows that an arbitration agreement in a securities transaction need not also contain signatures of both the parties to be valid. This contract note is drafted under a special statute i.e. the Securities Contracts (Regulation) Act, 1956 and mentions a clear stipulation of it being subject to the rules, byelaws and regulations notified by the relevant Stock Exchange. The mode of executing this contract note, according to the governing law, is the signature of a registered stockbroker. Hence 'the arbitration agreement contained in these special contracts are not arbitration agreements any the less, on the ground that the writing is not signed by both the parties'.[5]

Does an agreement require the specific incorporation of an arbitration clause?

For a valid arbitration agreement u/s 7 of the Arbitration Act, 1996, it is essential that the parties to an agreement must specifically agree to refer the dispute for arbitration. However, such an agreement may not specifically mention the words 'arbitration' or 'arbitrator'. An arbitration

[3] *What is a Contract Note*, Motilal Oswal (accessed 25 September 2023), https://www.motilaloswal.com/blog-details/what-is-a-contract-note/20247
[4] As mentioned under Regulation 3.6, National Stock Exchange (Futures & Options Segment) Trading Regulations.
[5] Viraj Holdings v. Motilal Oswal Securities Pvt. [2002 (6) BomCR 759].

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agreement in implied terms is also an equally valid one if it fulfills certain essential elements namely: "(a) The agreement should be in writing. (b) The parties should have agreed to refer any disputes (present or future) between them to the decision of a private tribunal. (c) The private tribunal should be empowered to adjudicate upon the disputes in an impartial manner, giving due opportunity to the parties to put forth their case before it. (d) The parties should have agreed that the decision of the Private Tribunal in respect of the disputes will be binding on them." [6]

However, whether arbitration is to be mandatorily proceeded with in case of a dispute in securities transaction is an interesting question and depends upon the question whether every securities transaction agreement has an implied arbitration clause or not. There have been two divergent views taken by the Hon'ble Bombay High Court and the Hon'ble Calcutta High Court on this.

It was submitted before the Hon'ble High Court of Bombay in the case of *Mrs. Asha Anilkumar Kataria v. Ashok kumar S/O Kevalchand Bafna*[7], that the arbitration clause is a statutory term of the agreement between the parties transacting and therefore arbitration is mandatory. The court rejected the contention and held that the regulations that were made, required an agreement between the parties giving specifications of their the scope of authority and responsibility, but the regulations don't mandate incorporating all the conditions in the agreement as mentioned in the model agreements of the stock exchange including an arbitration clause. Hence, the submission that the arbitration clause is a statutory term and condition of a securities transaction contract cannot be accepted and the application u/s 8 of Arbitration Act, 1996, that bars the court from entertaining a suit subject to arbitration would fail. The court also went ahead and held that the said regulations do not in any way take away the jurisdiction of the civil courts, but simply provide an alternative remedy- as it is a case of having a pre-existing right under common law and an additional remedy provided by way of an arbitration clause, which if mentioned by the parties in the agreement and with the express exclusion of the jurisdiction of the civil court provided, shall alone be valid.[8]

On the other hand, the Hon'ble Court in the case of *S & D Securities Pvt. Ltd. & Anr. v. Union Of India*[9] accepted the contention that the arbitration clause is a statutory term of the agreement

[6] Jagdish Chander v. Ramesh Chander & Ors (2007) 5 SCC 719.
[7] 2007 (5) BomCR 125.
[8] id.
[9] 2005 124 CompCas 340 Cal.

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between the parties transacting and therefore arbitration is mandatory for the parties, from which they cannot derogate. It held that once it is established that there is a dealing between the parties then, it shall be deemed that the Bye-laws, Rules and Regulations of the respective stock exchanges govern such contracts. Further, the idea of introducing the Securities Contracts (Regulation) Act, 1956 and the Bye-laws, Rules and Regulations is to regulate the dealings in securities. 'In all the Byelaws, Rules and Regulations burden has been placed on the trading member that they may not cheat bona fide customers who are interested in dealing in securities. Regulation 4.3.1 provides that if a broker fails to execute the agreement with his customer, the agreement shall be deemed to have been executed. Statute has made such a deeming provision. Therefore, an inference of a 'statutory deeming' has to be drawn in the scheme of the provisions of the Act, Byelaws, Rules and Regulations. Therefore, looking to all the deeming clauses, even if the arbitration agreement has not been entered into, then too it will be deemed that the parties are subject to the Bye-laws, Rules and Regulations of the Exchange and if any dispute arises between them, then they can certainly request the authorities to refer the dispute to arbitration.'[10]

It is submitted that the view taken by the Hon'ble Calcutta High Court, seems to be the correct interpretation of the legislative intent on two grounds. *Firstly*, the Arbitration and Conciliation Act, 1996 has all the features resembling a general statute. It deals with the whole gamut of subjects ranging from domestic arbitration to conciliation. In domestic arbitration also, it brings under its scope a wide of matters showing its general nature.[11] On the other hand the byelaws made by the stock exchanges under S. 9 of Securities Contracts (Regulation) Act, 1956, is a specific statute dealing with securities transactions. The maxim *Generalis Specialibus Non Derogant* means that in case of a conflict between a general statute and a special statute, the former must yield to the latter. Hence it is only logical that the byelaws of Stock exchanges providing for mandatory arbitration shall prevail over the Arbitration and Conciliation Act 1956.[12]

Secondly, the *Mischief Rule* of interpretation of statutes is that in applying a rule, the court shall inquire which particular mischief the authority enacting the statute intended to rectify, even though it might not be explicitly covered by a literal reading of the statute's wording. It must be noted that it was post the creation of SEBI in 1992, that there was a strong impetus towards

[10] id.
[11] Kohinoor Creations And Ors. v. Syndicate Bank, 2005 (2) ARBLR 324 Delhi.
[12] The Stock Exchange, Mumbai v. Vinay Bubna, AIR 1999 Bom 266.

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investor protection and ensuring fair play in the securities market. Hence the Arbitration mechanism was introduced for the purpose of protecting the investor and continues to be investor friendly in its working. Therefore, it is not erroneous to assume that the enacting authority intended the arbitration clause to be mandatory.

Is Arbitration Reserved for Securities Transaction Disputes only?

Another interesting case of implied contracts of arbitration came before the Bombay High Court in the case of *Newage Fincorp (India) Ltd. vs Asia Corp Securities Limited*[13], wherein the main question before the court was whether the dispute relating to a membership card (which empowers the holder to carry on the business of shares and securities in the stock exchange), could be the subject matter of arbitration under the byelaws which provided for claims or disputes arising out of or in relation to dealings, transactions and contracts of securities made subject to the rules, byelaws and regulations of the Stock Exchange. The parties entered a memorandum of understanding (MOU) for the purpose of nominating members for the membership card. One of the clauses stated that "both the parties shall take all the necessary steps to get the approval of this MOU as per the Companies Act or any other rules and regulations for the time being in force." It was contended that there was no arbitration agreement between the parties and the transaction relating to nomination of a member, which was the subject matter of the present MOU, cannot be termed as dealings in securities attracting the provisions of the Byelaws of the Stock Exchange. The Court rejected the contention and held that in the said clause, arbitration agreement may not be specifically mentioned in the MOU but it is to be deemed as a part of the MOU since the MOU specifically mentions that "both the parties shall take all the necessary steps to get the approval of this MOU as per the Companies Act or any other rules and regulations for the time being in force." which shall mean and be inclusive of the rules and byelaws notified by the Stock Exchange. It was held that the membership and nomination to exchange are governed by the rules framed by the Stock Exchange. Therefore, the MOU referred to, if understood in its proper perspective, will include reference to the rules, which by necessary implication make the byelaws applicable wherein any dispute between the parties arising out of contract can be referred to an arbitrator.

[13] 2000 (4) BomCR 273.

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Hence, the peculiar feature of Securities Arbitration under the Stock Exchange is that it is not solely reserved for disputes purely within the realm of the subject-matter for which it was created i.e. securities transactions. This is unlike other forms of arbitration, say for example Investment Arbitration that necessitates that the legal dispute must pertain to rights flowing out of an Investment Treaty alone to be arbitrated by ICSID[14], but encircles all or any of the disputes between parties, that are subject to the byelaws of the stock-exchange.

Can Arbitration only be between trading members of the stock exchange?

It is not always necessary that an aggrieved party maybe a member constituent of a stock exchange. The membership of a stock exchange can be lost by way of suspension, termination, surrendering etc. The right of the parties to invoke arbitration in case of losing their membership was dealt in *Harinarayan Bajaj v. Madhukar Sheth*[15]. In the present case, the respondent, a trading member of the stock exchange lost his membership owing to the cancellation of his certificate of registration by the exchange. The question before the court was whether the arbitration agreement still subsists and whether the trading member/respondent had the right to invoke arbitration because the rules of the stock exchange regulations state that a suspended member, faces exclusion from all the rights and privileges of membership till the term of suspension lasts. Further as per the rules, arbitration can take place only when the dispute is between a 'member' and 'non-member'. The court held that even such a suspended member had the right to invoke arbitration. It held that there would be no valid arbitration agreement where only one party is entitled to invoke arbitration and also the rules, bye-laws and regulations don't prevent a suspended member from filing for recovery of dues. However, in case the member filed a suit against the client and the client's application u/s 8 of the Arbitration Act, 1996 is allowed, the suspended member would be bereft of any remedy to recover his dues since he cannot take his claims to arbitration. On one hand his suit would have come to an end without adjudication on merits by virtue of the order under section 8 and on the other hand he would not be entitled to have his claim decided by arbitration. It would be unfair where the non-member does not agree to the suspended member referring his claim to arbitration thereby compelling him to pursue a civil suit but refers his claim to arbitration. The suspended member would not be entitled to raise

[14] ICSID Convention. art. 25.
[15] (2015) 3 BomCR 15.

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a counterclaim either and may lead to a conflict of decision between a public forum and a private forum.

Should Parties always have a contractual relationship?

Another interesting decision on this subject came from the Hon'ble High Court of Madras in the case of *Rajanarayan Capital Markets v. S.S. Chokkalingam*[16]. In the present case the petitioner was a trading member of the stock exchange and had appointed a firm as their dealer and started with the trading activities. There arose a dispute between the firm and the respondent, and consequently the respondent invoked arbitration against the petitioner, on the ground that the firm in question was their agent since it still made certain payments to the petitioner and attended investor meetings arranged by the petitioner. The petitioner contended that the firm was their client, and their contractual relationship came to an end in the past. The court held that the inference of the arbitrator that the firm was petitioner's agent/sub-broker was untenable and the award could not be passed against them on this ground, since the byelaws clearly provide that the nature of the relationship between the parties must be contractual and only if such a contractual relationship exists, the provisions of the regulations can be deemed to be a part of such contract.

How far is the *ratio decidendi* in *Rajnarayan Capital Markets*[17] valid after the decision of the apex court in *Cox and Kings Ltd v. SAP India Pvt Ltd*[18], which upheld the application of the Group of Companies doctrine to Arbitration agreements, is a polemical subject. The Doctrine of "group of companies" in simple words means that a party that is a non-signatory can be bound by an arbitration agreement if it is a member of the same group of companies as the signatory and all the parties to the arbitration agreement mutually intend that the non-signatory be bound by it. The parties' intentions are usually determined by their conduct, which can include determining whether the non-signatory was found to be engaged in the negotiation, performance or termination of the contract. The mere presence of an affiliate relationship between a signatory and a non-signatory cannot be used as a foundation for consent. The "group of companies" concept, unlike other non-signatory theories that are based on domestic law principles, is based on international arbitration jurisprudence.[19] Considering the above, it can be safely inferred that

[16] Tr.O.P.No.437 of 2007.
[17] id.
[18] ARBIT. PETITION No. 38/2020
[19] Gauri Anand, India: *'Group Of Companies' Doctrine: An Analysis In The Context Of Arbitration* (Dec. 8, 2023, 9:29 AM) https://www.mondaq.com

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the ratio in Rajanarayan capital shall be read in consonance with Cox Cap, and shall be applicable only in cases where the group of companies doctrine is inapplicable to the facts of the case.

Part II

Interim Measures by Court: -

A party may file an application u/s 9 of the Arbitration Act, 1996, to the court to obtain any interim relief. The Court before the grant of interim measures of protection must broadly satisfy itself that (a) the person seeking interim measures has made out a prima facie case (b) the balance of convenience is in his favour and (c) the person in absence of interim measures would suffer irreparable loss or injury. It has been time and again repeated that in granting or refusing to grant interim measures, the Court has wide discretion u/s 9 of Arbitration Act, 1996, however the exercise of this discretion has to be in a judicial manner depending upon the circumstances of each case. There can be no hard and fast rule that can be laid down as regards the exercise of such discretion. However, in the case of interim relief, the standard rule being that the Court must be satisfied that the petitioner has a prima facie case, does not mean that the Court shall examine the merits of the case minutely and conclude that the petitioner's case might succeed. This would be a case prejudging the claims of the parties on their merits. The court has to only see that prima facie the party claiming an interim relief has a case that needs consideration and the balance of convenience also has to be looked into.[20]

In *Newage Fincorp (India) Ltd. Case* [21], the petitioner had applied for interim relief for preservation of property u/s 9 of the Arbitration Act, 1996. The relief sought was that the respondent shall ensure that the possession of the membership card is not alienated in any way or third-party rights are not created therein, until there was a final determination by the arbitrator. Rules of the Stock Exchange, provided that a party being a member for a period of minimum three years, alone can nominate a person meeting the eligibility criteria under the Rules for admission to membership of the Exchange in their place, in case they resign. The respondent terminated the contract, alleging breach by the petitioner. They also contended that since the membership card does not fall within the definition of property given under the Transfer of Property Act 1882, and it being purely a personal privilege, the same cannot be the subject matter

[20] *Newage Fincorp (India) Ltd. v. Asia Corp Securities Ltd*. 2000 (4) BomCR 273.
[21] ibid.

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of arbitration and by consequence there can be no interim relief sought for preservation of property u/s 9 of Arbitration Act, 1996. The court held that the scheme of the rules provides for nomination by a member and the possibility of a dispute between the parties arising out of nomination cannot be completely ruled out. The rules providing a mechanism to resolve disputes via the byelaws of the stock exchange also cannot be ruled out and hence the arbitration mechanism provided in the byelaws cannot be denied. It further held that, the dispute between the parties has given rise to serious issues meriting a trial. If via nomination, the membership of the stock exchange is allowed to be transferred, in favour of any third party, then it shall give rise to multiple proceedings, and the so created third party rights shall not be the subject matter of arbitration disputes between the present parties. Membership of the stock exchange is a commercial privilege and loss of commercial privilege cannot be monetarily compensated and hence, it shall be appropriate to consider the preservation of the subject matter of the arbitral dispute as essential by allowing interim relief, as the balance of convenience lied in the petitioner's favour.

Specific performance in the case of determinable securities contract: -

Section 14 of the Specific Relief Act, 1963 states that a contract is determinable if it can be put to an end. This means that any contract that may be possibly voided in any way is under the ambit of determinable contracts. In the case of *Indian Oil Corporation Ltd v. Amritsar Gas Service*[22], the Apex Court defined what a determinable contract is. It stated that an agreement, which contains a clause that shall give a right to any of the parties to terminate an agreement by giving a prior notice, and without assigning any reason, is 'determinable' in nature, and hence cannot be specifically enforced. The only relief that can be granted is compensation for the loss of earnings and not specific performance.

In the case of *Integral Finvest (P) Ltd. v. SEBI*[23], before Delhi High Court, the petitioner had prayed for an interim injunction u/a 226 of the Constitution, asking the court to restrain the SEBI from transferring or varying the shareholdings of the respondent until a final award has been passed in the arbitration proceedings. Directions were also sought against the respondents to withdraw the publication of the public offer and prohibit dealings in or allow change of control and management relating to the respondent's shareholding, which is the subject matter of the

[22] (1991) 1 SCC 533.
[23] (2007) 2 CompLJ 433 Del.

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disputes between the parties under the memorandum of understanding (MOU). The parties had entered a MOU, which contemplated the transfer of shares from the respondent to the petitioner, via a subsequent agreement through which the execution of the MOU had to be worked out including the price at which the shares were to be transferred. The court reasoned that the MOU between both the parties was of a determinable nature, and specific performance of the same cannot be asked for. The court reasoned that even if a particular clause enabling the parties to terminate a contract, in case the events mentioned therein occurred, is absent, the fundamental nature of the impugned agreement being a private commercial transaction, it can be concluded that the same could be terminated even without assigning any reason by serving a reasonable notice. In the eventuality of the termination being found bad in law, the remedy is to file a suit for compensation for wrongful termination and not a claim for the specific performance of the contract.

Conclusion

Arbitration has played a considerable role in building investor confidence and ensuring a ease of investment in the stock market over the years. One may even go to the extent of concluding that the introduction of a simple and investor friendly dispute resolution mechanism has democratized the securities industry. However, conflicting judgements from various high courts and lack of awareness and judicial predictability amongst investors can surely act as an impediment. It is suggested that such important questions of judicial interpretation shall be settled by the highest court, or the apex regulator i.e. SEBI at the earliest.

Also India's lack of credibility with respect to enforcement of foreign awards negatively impacts the evolving arbitration ecosystem. To strengthen its effectiveness, continued efforts are needed to enhance transparency, accessibility, and enforcement of arbitration awards, both domestic and foreign. The way forward involves regulatory refinements and investor education to foster a resilient and investor-friendly market ecosystem.

It is also important that we prepare adequately for disruptions like Artificial Intelligence based Online Dispute Resolution (ODR) that can potentially threaten professionals, and add uncertainty to the relevance of contemporary dispute resolution mechanisms. In this regard it is submitted that the government, judiciary, advocates, industry stake holders and civil society members should come forward in unison and a new National Dispute Resolution Policy with sufficient

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emphasis on securities arbitration should be rolled out to prepare all the stake holders and familiarize them with the new changes that are expected to come sooner or later. Alternatively, the proposed Arbitration Council of India in the Arbitration and Conciliation (Amendment) Bill, 2021 should be created at the earliest and given the mandate to deal with this subject.