

RAMACHANDRAN
v
COMMERCIAL LEASING CO. LTD AND ANOTHER

COURT OF APPEAL
AMARATUNGA, J. AND
BALAPATABENDI, J.
CALA 375/01
D.C. COLOMBO 43938/MHP
AUGUST 29, AND
SEPTEMBER 10, 2002

Civil Procedure Code, sections 147, 693 and 698 – Issues of law to be tried first – Arbitration agreement - Arbitration Act, No. 11 of 1995 sections 2 (1), 2 (2) and 47 – Arbitration Ordinance, section 7 - Conditions precedent to institution of action or bare agreement to arbitrate?

The 2nd defendant petitioner, raised two legal issues, and invited court to consider the said Issues on jurisdiction - framed as issues of law. The learned trial judge disallowed the application.

It was contended that section 5 of the Arbitration Act debars the jurisdiction of court in respect of disputes covered by the arbitration agreement.

Held:

- (i) Arbitration clauses in contracts are of two main kinds, (i) bare arbitration agreements (ii) agreements making an arbitration award a condition precedent to any right of action.
- (ii) The lease agreement and the guarantee bond have been entered into by the parties on 17.7.75. The Arbitration Act, No. 11 of 1995 came into operation on 1.8. 1995. Though section 5 debars the jurisdiction of court in respect of a dispute covered by an arbitration agreement, the Act came into operation after the execution of the lease agreement. The parties are bound to oblige with conditions of agreement entered at the time of its execution.
- (iii) On a perusal of the lease agreement, the only inference that could be drawn is that, the option for arbitration/or to institute legal proceedings in court is vested with the lessor,
- (iv) The arbitration clause in the lease agreement is only a bare agreement to arbitrate and is not a condition precedent to the institution of legal action in court.

APPLICATION for leave to Appeal from the Order of the District of Colombo.

Cases referred to:

1. *Hotel Galaxy (Pvt) Ltd., v Mercantile Hotels Management Ltd.* (1987) 1 Sri L.R.5
2. *Scott v Avery* - (1865) 5 HGLR case 811
3. *Gorden Frazer (Pvt) Ltd., v Jean Marie Casio and Marlin Wenzel* - (1984) 2 Sri LR 85

Hemantha Situge for 2nd defendant-respondent

Bimal Rajapakse for respondent.

Cur.adv. vult.

November 14, 2002

BALAPATABENDI, J.

This is an application for leave to appeal against an order 01 made by the learned District Judge on 08.10.2001.

The plaintiff-respondent (a Company) instituted an action against the 1st defendant-respondent and the 2nd defendant-petitioner to recover the moneys due to the plaintiff-respondent on the Lease Agreement marked as "A" and on the guarantee of the Lease Agreement marked as "B". The Lease Agreement marked "A" indicates that the 1st defendant and the 2nd defendant-petitioner together entered into an Agreement as partners in a partnership with the plaintiff-respondent (a company) and also the 2nd defendant-petitioner 10 separately entered into a guarantee of the Lease Agreement "A" with the plaintiff-respondent by document marked "B".

The 2nd defendant-petitioner moved Court to amend his original answer filed, by expressly traversing an averment as to the jurisdiction of the Court. Court allowed the amendment of the answer by the order 11.08.99.

At the trial on 29.5.2000 2nd defendant-petitioner raised two legal issues, among other issues, to wit:-

(5) whether this Court has jurisdiction to hear this case?

(මෙම නඩුව විසඳීමට මෙම අධිකරණයට බලය තිබේද?)

(6) If the above issue (5) is determined in favour of the 2nd defendant, could the plaintiff have and maintain this action against the 2nd defendant?

(ඉහත විෂයතාව (5) 2 වෙනි විත්තිකරුගේ වාසියට නිතරු වෙ නම පැමිණිලිකරුට 2 වැනි විත්තිකරුට එරෙහිව මෙම නඩුව පවත්වාගෙන යා හැකිද?)

As the plaintiff-respondent objected to the above mentioned two issues, the learned Distinct Judge made an order accepting the two issues.

Thereafter, on the next trial date (25.4.2001) the counsel for the 2nd defendant-petitioner made an application under section 147 of the Civil Procedure Code, to consider these two issues framed as issues of law, and submitted that the case could be disposed of by answering those two issues. On the written submissions filed by both parties the learned District Judge disallowed the application on 08.10.2001. The case was fixed for further trial on all the issues (1 to 7) framed before Court. This leave to appeal application was preferred against that order. 30

The contention of the 2nd defendant-petitioner was that in the Agreement marked 'A' clause 16 contains an 'Arbitration-Clause which reads as follows:- 40

- (1) "In the event of any default or non-observance by lessee of the terms and conditions contained in this lease Agreement or in other case and in the event of any dispute, difference or question which may from time to time and at any time hereafter arise or occur between lessor and lessee or their respective representatives or permitted assigns touching or concerning or arising out of, under in relation to it in respect of this lease agreement or any provision matter or thing contained herein or the subject matter hereof, or the operation, interpretation or construction hereof or of any clause hereof or as to the rights duties or liabilities of either party hereunder or in connection with the premises or their respective representatives or permitted assigns including all questions that may arise after the termination or cancellation of this lease, such dispute, difference or question may, not withstanding the remedies available under this Lease 50

Agreement or in Law, by lessor only, after 14 days of lessor presenting its final claim on disputed matters, be submitted in writing as *its sole option for arbitration* by a single arbitrator to be nominated by the parties or if such nomination is not practicable, by two arbitrators one to be appointed by lessor and the other by lessee and an umpire to be nominated by the two arbitrators and if either party refuses to nominate an arbitrator by a sole arbitrator to be nominate by the other party."

- (2) "Lessor shall forthwith notify lessees of every matter in dispute or difference so submitted, and only such dispute or difference which has been so submitted and no other shall be the subject of arbitration between the parties. It is hereby agreed that if either party refuses to take part in the arbitration proceedings or does not attend the same the arbitrator or the arbitrators and the umpire shall and shall be entitled to proceed with the arbitration in the absence of such party and make his or their award after notice to such party. The relevant provisions of the Arbitration Ordinance (Cap 98) and the provisions of the Civil Procedure Code or any statutory re-enactment or modifications thereof for the time being in force in so far as the same may be applicable shall govern and shall be applicable to such arbitration".

Clause 16 of the Agreement debars the jurisdiction of the courts to hear and determine this case - section 47 of the Arbitration Act, No.11 of 1995 has repealed

- (i) the Arbitration Ordinance (Chapter 98) and
- (ii) Sections 693 to 698 of the Civil Procedure Code (Chapter 101).

Hence this Lease Agreement now falls within the purview of the Arbitration Act, No. 11 of 1995.

It is interesting to note that the Lease Agreement 'A' and the Guarantee Bond 'B' have been entered into by the parties on 17.7.1995. But the Arbitration Act, No. 11 of 1995 came into operation in 1st August 1995. (Admitted by the 2nd defendant-petitioner)

To circumvent this problem the 2nd defendant-petitioner states that Part I preliminary section 2(1) of the Arbitration Act is pertinent to this question. Section 2(1) states that

"The provisions of this Act shall, subject to the provision of section 48 apply to all arbitration proceedings commenced in Sri Lanka after the appointed date, whether the arbitration agreement in pursuance of which *such arbitration proceedings are commenced* was entered into before or after the appointed date." 100

It is obviously clear that it applies only to cases where, "*Such arbitration proceedings are commenced*" (emphasis added)

Section 2(2) of the Arbitration Act states that "Where arbitration proceedings were commenced prior to the appointed date the Law in force prior to the appointed date, shall, unless the parties otherwise agree, apply to such arbitration proceedings." section 5 of the Arbitration Act, No. 11 of 1995 states that "Where a party to an arbitration agreement institutes legal proceedings in a Court against another party to such agreement in respect of a matter agreed to be submitted for arbitration under such agreement, the Court shall have no jurisdiction to hear and determine such matter if the other party objects to the Court exercising jurisdiction in respect of such matter". 110

Though section 5 of the Act debars the jurisdiction of Court in respect of a dispute covered by an arbitration agreement, the Act came into operation after the execution of the Agreement 'A'. Therefore the parties to the agreement are bound to oblige with conditions of agreement entered at the time of execution of it.

As to the 2nd cause of action, on the Guarantee of Lease Agreement (marked as 'B') the 2nd defendant-petitioner alleged that the plaintiff-respondent could not have and maintain the action because clause 1 of the Guarantee Bond 'B' is incorporated with the arbitration clause - 16, in the Lease Agreement 'A'. 120

The contention of the plaintiff-respondent was that, the 2nd defendant-petitioner in his amended answer while admitting paragraph (3) of the plaint, which relates to the cause of action and to the jurisdiction of the District Court has however averred in the answer that the District Court cannot hear and adjudicate the suit *per-se*.

It was on that background that the two issues (5) and (6) were framed, and allowed by the Court.

The plaintiff-respondent contended that, it is very clear in the Lease Agreement that the arbitration clause (16), (*supra*) – contains the sole option to resort for arbitration is entirely left with the plaintiff respondent (the Lessor),

(1) In *Hotel Galaxy (Pvt) Ltd v Mercantile Hotels Management Ltd.*⁽¹⁾ It has been held that "arbitration clauses in contracts are of two main kinds, namely:-

(a) bare arbitration agreements, when the parties agree that disputes arising out of the contract shall be referred to arbitration; here, the provision for arbitration is a mere matter of procedure for ascertaining the rights of parties with nothing in it to exclude a right of action on the contract itself but leaving it to the party against whom an action may be brought to apply to the discretionary power of the Court to stay proceedings in the action in order that the parties may resort to the procedure to which they have agreed. 140

(b) agreements making an arbitrator's award a condition precedent to any right of action under the contract based not upon the original contract but upon the award made under the arbitration clause. 150

In the case cited above Sharvananda, CJ has stated that, a bare agreement to arbitrate cannot be pleaded in bar of an action on the contract. But under an agreement with *Scott v Avery*⁽²⁾ clause, the right to bring an action depends upon the result of the arbitration; arbitration followed by an award is a condition precedent to an action being instituted. Where a dispute is governed by such a condition an action in respect of that dispute cannot succeed. On such an arbitration clause, arbitration is not a mere matter of procedure, but the proceeding to arbitration is essential to a right of action in the plaintiff. But there is statutory provision in English Law vesting the court with discretion to override a *Scott Avery Clause*." 160

In *Gordon Frazer (Pvt) Ltd v Jean Marie Losio and Marlin Wenzel*⁽³⁾ It had been held that:-

(1) "The provision in the contract for reference to arbitration is not a *Scott v Avery* clause and is not a condition precedent to

the institution of an action. The jurisdiction of the Court is not ousted by the failure to refer the dispute to arbitration. An agreement to oust the jurisdiction of the courts altogether is illegal and void as being contrary to public policy. Where there is an agreement between the parties to refer their differences to arbitration and one of the parties commences a suit without prior recourse to arbitration, the Court can on application made to it stay the proceedings and refer the matter to arbitration under section 7 of the Arbitration Ordinance. But only the parties to a contract containing an arbitration clause can have recourse to section 7 of the Arbitration Ordinance."

(2) "where the defendants are trying to repudiate the contract entered into by them with the plaintiff-petitioner, such a dispute constitutes a dispute "relative to" the contract and falls within the arbitration clause set out in the contract".

The 2nd defendant-petitioner alleged in his amended answer para (4) that the calculation of the accounts by the plaintiff-respondent was erroneously and/or falsely done which in itself is an allegation brought on the Lease Agreement and on the Guarantee Bond, which has to be decided on evidence.

It is significant to note that, the 2nd defendant-petitioner did not make an application under section (7) of the Arbitration Ordinance to "*stay the proceedings and refer the matter to arbitration* at any time in the proceedings in the District Court, as the Lease Agreement marked 'A', has provided for the application of the provisions of the Arbitration Ordinance.

It is very pertinent to note that in the Lease Agreement marked 'A' there is a clause for jurisdiction. Clause (19) states that:-

'(1) This Agreement shall be deemed to have been entered into at the place where it has been signed by the lessor."

(2) All moneys payable to the lessor by the lessee and or parties to this agreement which shall include herein rentals, damages, insurance premia, compensation for depreciation etc. shall be made at the registered office of the lessor No. 21, Bristol Street, Colombo 01 and nowhere else. Where the lessee makes payment elsewhere or to or through any other source that aforesaid obligation to pay only at the lessor's registered office shall remain

unchanged notwithstanding the fact that said moneys are accepted by or on behalf of the lessor."

"The obligation to make the aforesaid payments only at the lessor's registered office is not intended to be waived or modified or extinguished by acceptance of moneys elsewhere than at the lessor's registered office and shall not be treated as having been so waived modified or extinguished. *In the event of default to make any of the aforesaid payments the causes of action for purposes of instituting legal proceedings shall arise within the jurisdiction of the appropriate Court within whose jurisdiction the lessor's registered office is situated. "Causes of action mean the wrongs with respect to which legal proceedings are to be instituted."*

For the aforesaid premise, the only inference that could be drawn on the Lease Agreement 'A' is that the option for arbitration/or to institute legal proceedings in Court is vested with the lessor.

I am therefore of the view that the arbitration clause in the Lease Agreement marked 'A', is only a bare-agreement to arbitrate, and is not a condition precedent to the institution of legal action in Court.

On a perusal of the order made by the learned District Judge, it is clear that to ascertain whether the Court is vested with the jurisdiction to hear the case, evidence has to be led on the Lease Agreement and on the Guarantee Bond, to answer all the issues (1 to 7) framed before Court.

The above mentioned facts when taken into consideration, it shows that the finding of the learned District Judge to proceed with the case and to adjudicate on all the issues framed was a correct decision.

For the aforesaid reasons, I refuse to grant leave to appeal, casting the 2nd defendant-petitioner costs in a sum of Rs. 7500/-

AMARATUNGA, J. - I agree

Application refused.