IN THE SUPREME COURT OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

In the matter of an Application for Leave to Appeal in terms of Section 5(2) of the High Court of the Provinces (Special Provisions) Act No. 10 of 1996, read with Section 6 of the said Act, Article 128 of the Constitution and Chapter LVIII of the Civil Procedure Code (Chapter 101) against the order dated 7.10.2008 delivered in H.C. (Civil) Case No. 247/07/MR.

Elgitread Lanka (Private) Limited,
No. 9, Industrial Estate,
Dankotuwa.

DEFENDANT-PETITIONER-APPELLANT

SC (Appeal) No. 106/08
SC (HC) LA No. 37/2008
HC (Civil) No. 247/07/MR

VS.

Bino Tyres (Private) Limited,
Dankotuwa Industrial Estate,
Lihiriyagama Road,
Dankotuwa.

PLAINTIFF-RESPONDENT-RESPONDENT

BEFORE : Saleem Marsoof, P.C., J.,
P. A. Ratnayake, P.C., J. &
S. I. Imam, J.

COUNSEL : M. E. Wickramasinghe for the Defendant-Petitioner-Appellant.

Rasika Dissanayaka with Chandrasiri Wanigapura for the Plaintiff-Respondent-Respondent.

ARGUED ON : 30.06.2009

WRITTEN SUBMISSIONS: 30.07.2009

DECIDED ON : 27.10.2010

SALEEM MARSOOF, J.

This is an appeal from the judgement of the Commercial High Court of Colombo dated 7th October 2008, which overruled the contention of the Defendant-Petitioner-Appellant (hereinafter referred to as the "Appellant") that the said High Court has no jurisdiction to hear and determine the action filed by the Plaintiff-Respondent-Respondent (hereinafter referred to as the "Respondent") in view of Section 5 of the Arbitration Act, No.11 of 1995.

The Respondent, Bino Tyres (Pvt.) Ltd., instituted action in the Commercial High Court of Colombo for the recovery of a sum of Rupees 40,000,000/- as damages for the alleged breach of

the Franchise Agreement dated 2nd June 2005, whereby the Appellant, Elgitread Lanka (Pvt.) Ltd., had agreed to grant the Respondent a franchise to use a system for re-treading tyres in conjunction with the use of the trademark and trade name of the holding company of the Appellant, Elgitread India Ltd., and to provide technical assistance to set up a tyre re-trading plant in Dankotuwa. Clause 14 of the said agreement reads as follows:

> "Any dispute arising out of this Agreement shall be referred to the Sri Lanka Chamber of Commerce and Industry, Colombo, for arbitration, whose decision shall be binding and final".

The Appellant, in its answer, objected to the jurisdiction of the Commercial High Court on the basis that by reason of the agreement to arbitrate contained in Clause 14 of the Franchise Agreement, the Court cannot hear and determine any dispute that may arise from the said agreement, as Section 5 of the Arbitration Act No. 11 of 1995 takes away the jurisdiction of court when objection is taken to the exercise of jurisdiction by Court. At the trial, the Respondent, however, took up the position that there was no agreement to refer the dispute for arbitration, or alternatively, the agreement to refer the dispute for arbitration is frustrated, because there does not exist in Sri Lanka any entity by the name of 'the Sri Lankan Chamber of Commerce and Industry, Colombo'.

Several issues which had a bearing on the said jurisdictional objection were identified as preliminary issues at the trial, and were eventually taken up for determination by the learned Commercial High Court Judge, prior to considering the case on its merits. The said issues are reproduced below :-

Raised by the Plaintiff-Respondent-Respondent

1. Does the Agreement annexed to the Plaint marked X1 contain a valid arbitration clause / arbitration agreement?

2. In any event, has the Appellant failed every attempt by the Respondent to refer the matter to arbitration?

3. If so, does this Court have jurisdiction to hear and determine this action?

Raised by the Defendant-Petitioner-Appellant

8. (a) Is the purported cause of action pleaded by the Plaintiff based on the Franchise Agreement, a true copy whereof has been filed with the Plaint marked X1?

   (b) Does Clause 14.0 of the said Agreement contain an arbitration clause and / or an arbitration agreement within the meaning of the said term in the Arbitration Act No. 11 of 1995?

   (c) Has the Defendant objected to this Court exercising jurisdiction in this action?

   (d) In the circumstances does this Court have no jurisdiction to hear and / or determine this action?

   (e) If so, should the Plaint be rejected and / or the Plaintiff's action dismissed?

10. (a) Does Clause 14.0 of the said Agreement X1 contain an Arbitration Clause ?

(b) Has the Defendant at all times maintained that any dispute between the parties should be referred to arbitration in accordance with the said Clause?

(c) Has the Defendant objected to this Court exercising jurisdiction in respect of this matter?

The learned Judge of the Commercial High Court has in his judgement dated 7th October 2008, answered all the above issues 1, 2, 3, 8 and 10 in favour of the Respondent, on the basis that insofar as there is no entity in existence with the name 'the Sri Lankan Chamber of Commerce and Industry, Colombo', the agreement to arbitrate contained in Clause 14 of the said Franchise Agreement is incapable of being given effect to, and is therefore void *ab initio*. The Commercial High Court concluded that it had jurisdiction to proceed to trial on the other issues formulated by the parties. This appeal is against the said judgement, and leave to appeal has been granted by the Supreme Court on the following substantive questions:-

(a) Did the High Court err in law in failing to appreciate that Clause 14 of the Agreement was an 'arbitration agreement' within the meaning of the said term in Section 3 of the Arbitration Act, and the Court therefore has no jurisdiction over the matter by reason of the Appellant's objection in terms of Section 5 of the Arbitration Act?

(b) Did the High Court err in law in ignoring Section 4 of the Arbitration Act which provides that a dispute that the parties have agreed to submit to arbitration under an 'arbitration agreement' may be determined by arbitration unless the matter in respect of which the arbitration agreement was entered into is contrary to public policy or is not capable of determination by arbitration?

(c) Did the High Court fail to apply the provisions of the Arbitration Act and in particular Section 7 thereof which provides for the appointment of the arbitrators in terms of the provisions thereof in the absence of agreement between the parties for the appointment of arbitrators?

Does Clause 14 consist of an agreement to arbitrate?

The first substantive question of law that has to be decided on this appeal is whether the Commercial High Court of Colombo err in law by failing to appreciate that Clause 14 of the Agreement was an 'arbitration agreement' within the meaning of Section 3 of the Arbitration Act, 1995, and that the Court had no jurisdiction to hear and determine the action filed by the Respondent by reason of the Appellant's objection to jurisdiction taken in terms of Section 5 of the Arbitration Act. Learned Counsel for both parties concede that the existence of a valid and enforceable agreement to arbitrate was an essential pre-condition for the application of Section 5 of the Arbitration Act, which reads as follows:-

> "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." (*emphasis added*)

It is also a pre-condition that the defendant or respondent to the court action or proceeding should have objected to the exercise of jurisdiction by court in respect of the matter which the parties have agreed to resolve by arbitration. Since the Appellant has in its answer objected to the exercise of jurisdiction by court, the focus of submission of Counsel was in fact on Clause 14 of the Franchise Agreement, and whether it amounted to a valid agreement to arbitrate.

The basic elements of an agreement to arbitrate relate to (a) formal validity and (b) essential validity. As submitted by Learned Counsel for the Appellant, the formal requirements of an arbitration agreement are set out in Section 3 of the Arbitration Act of 1995, which provides that such an agreement should take the form of an arbitration clause in a contract or should consist of a separate agreement, which is popularly known as a 'submission agreement'. There is no doubt that in this case, Clause 14 of the Franchise Agreement satisfies these formal requirements, and the thrust of the submissions of Counsel was on the essential requirements for the validity of an arbitration agreement.

Learned Counsel has invited the attention of court to Section 50 of the Arbitration Act, which sheds some light in regard to the meaning of the phrase 'arbitration agreement' as used in Section 5 of the said Act. Section 50 of the Act, seeks to define an 'arbitration agreement' in the following manner:-

> "Arbitration Agreement" means *an agreement by the parties to submit to arbitration all or certain disputes* which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not." (*emphasis added*)

The question that has to be addressed in the context of this appeal is whether Clause 14 of the Franchise Agreement amounted to an agreement by the parties to submit to arbitration any dispute that may arise from the said Agreement. Just as much as there can be no arbitration without a valid arbitration agreement, there can be no agreement to arbitrate without a manifestation of consent of parties to submit to arbitration any dispute that may arise from a contract entered into by them or other defined legal relationship. Learned Counsel for the Appellant has referred us to a passage in *Russell on Arbitration,* 22nd edition by David St. John Sutton and Judith Gill page 35 paragraph 2-025, where the authors observe that "the Courts seek to give effect to the parties' intention to refer disputes to arbitration, and to allow the tribunal full jurisdiction except in cases of hopeless confusion". Counsel has cited several illustrative cases including *Astro Vencedor Compania Naviera S.A. v. Mabanaft G. M.B.H.* [1970] 2 Lloyd's Reports 267, in which when considering whether a claim of damages for tort can be brought within purview of the arbitration clause that formed part of the contract sued upon in that case, the Court in providing an affirmative answer, emphasized that at page 271 that "the decision must in every case depend upon the facts, but the Court should if the circumstances allow, lean in favour of giving effect to the arbitration clause to which the parties have agreed." Learned Counsel for the Appellant has also relied on Section 4 of the Arbitration Act of 1995, which provides that a dispute coming within the purview of an arbitration agreement may still not be capable of being resolved by arbitration if it is "contrary to public policy or, is not capable of determination by arbitration". In my view, this provision does not have a direct bearing on the issue before us, as no question of public policy or arbitrability is raised in this case. What we need to decide, is the issue whether there is an agreement between the parties to have any dispute arising from the Franchise Agreement resolved through arbitration, in the context of the omission to specify an existing arbitral institution in Clause 14 of the said Agreement.

Indeed, Learned Counsel for the Respondent did not, in the course of the hearing of this appeal, seriously contest the position that in Clause 14 of the Franchise Agreement was a clear manifestation of consent of the parties to refer any dispute that may arise under the Agreement for arbitration. On the contrary, it was his contention that the intention to refer any dispute that may arise from the said Agreement for arbitration has been defeated by physical impossibility. Learned Counsel for the Respondent submitted that an agreement to arbitrate is in essence a contract, which like all other contracts, will be frustrated and discharged by reason of any unforeseen impossibility of performance. He has, in the course of his submissions, cited the celebrated decision in *Taylor v Caldwell* (1863) 3 B & S 826 and a passage from Justice (Dr.)

C.G. Weeramanthry's *Law of Contracts*, Vol II page 747, wherein he explains that the implication of a condition exempting a party from liability in circumstances where performance is rendered impossible due to no fault of such party also extends to a situation where "the subject matter of the contract is destroyed or when the condition or state of things contemplated by the parties as the foundation of their contract has ceased to exist or not been realized". He argues that when the parties to the Franchise Agreement agreed upon Clause 14, they had mistakenly but honestly assumed that there is an institution by the name of 'the Sri Lanka Chamber of Commerce and Industry, Colombo', functioning as an arbitration centre or providing facilitates for the conduct of arbitration to which any dispute can be referred for resolution by arbitration, and the consequence of that fundamental assumption being proved to be false is that the so called 'arbitration agreement' has been discharged or is at an end. Hence, it is contended that, since one of the essential pre-conditions for the application of Section 5 of the Arbitration Act does not exist, the only available remedy for the Respondent is to resort to a court action. Learned Counsel for the Respondent has also submitted that Clause 14 is not a *Scott v Avery* clause, and reference for arbitration is therefore not a condition precedent for the institution of the action.

It is at this stage convenient to deal with the submission that Clause 14 of the Franchise Agreement is not a *Scott v Avery* clause. *Scott v Avery* (1836) 5 HL Cas 811 was a decision of a bygone era in which it was trite law that the parties cannot by contract oust the jurisdiction of the court (*See, Thompson v Charmock* (1799) 8 Term Rep 139). The refinement to that rule introduced by the House of Lords in *Scott v Avery*, was that the stipulation in an arbitration clause in a contract that the award of an arbitrator is a condition precedent to the enforcement of any rights under the contract, effectively prevented a cause of action arising to enable a party to sue under the contract until and unless a favourable award has been obtained, or the other party has by his conduct forfeited the right to rely on it. In *Hotel Galaxy (Pvt) Ltd., v. Mercantile Hotels* [1987] 1 Sri LR 5 at page 10, Sharvananda, C.J., compared the then existing statutory provisions in England with those that existed in Sri Lanka and observed 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* 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."

The Supreme Court in that case took the view that the absence in Sri Lanka of statutory provisions of the kind then found in England, such as Section 25(4) of the Arbitration Act, 1950 which conferred on court the jurisdiction to override even a *Scott v Avery* clause in appropriate cases, meant that "our courts are bound to give effect to the agreement of the parties that no cause of action should accrue until liability under the contract is determined by an arbitral award." At pages 10 and 11 of his judgement, Sharvananda CJ., emphasized that the mandatory reference to arbitration is not a matter of mere procedure, and affected the substantive right to resort to court.

Although the point does not directly arise in this appeal, and no post-1995 pronouncement has been cited in the course of argument, it appears to me that the distinction between a bare arbitration clause and a *Scott v Avery* clause which was drawn in the *Hotel Galaxy* judgement is altogether obliterated by Section 5 of the Arbitration Act of 1995, which expressly lays down that where legal proceedings are instituted in a court by a party to an agreement to submit any matter for arbitration against another party to such an agreement, the Court shall have no jurisdiction to hear and determine such matter *if the party against whom proceedings are instituted objects* to the court exercising jurisdiction in respect of such matter. This is because Section 5 does not purport to maintain the said distinction, and on the contrary, seeks to extend the *Scott v Avery* refinement that a court would not exercise its jurisdiction to determine the case on its merits even to a mere arbitration clause which is not couched in the *Scott v*

Avery format. Hence, in my view, it does not matter whether Clause 14 of the Franchise Agreement is a *Scott v Avery* clause or not.

As for the other submission made by learned Counsel for the Respondent that Clause 14 of the Franchise Agreement is not a valid agreement to arbitrate, it is necessary to emphasize that our courts have been increasingly supportive of the arbitral process, and readily give effect to the intention of the parties to resolve their disputes though arbitration. A striking illustration of this judicial attitude is provided by the decision in *Mangistaumunaigaz Oil Production Association v United World Trade Inc.* [1995] 1 Lloyd's Reports 617. In this case, the arbitration clause simply stated: "Arbitration, if any, by ICC Rules in London." The commencement of arbitration proceedings was resisted by one of the parties on the basis that there was no valid arbitration agreement as the said clause merely manifested an intention that, if and only if, the parties on a later date mutually decided to refer the matter for arbitration, then the ensuing arbitration proceedings would be governed by the ICC Rules. In rejecting this contention, Potter, J. at page 621 observed as follows:-

> "In my opinion the clause as a whole, read in the context of an international contract for the sale of oil, demonstrates that the parties intended to settle any dispute which might arise between them by arbitration according to I.C.C. rules in London with English law to apply. The alternative is that, by providing for arbitration "if any", the parties were merely binding themselves in advance to the arbitral rules and venue which would govern any ad hoc agreement for arbitration which they might subsequently make if a dispute arose. The terms of the written contract suggest no need or reason to take so unusual a course. I consider that the commercial sense of an agreement of this kind, and the presumed contractual intention of the parties in importing the words used, can best be effected either by treating the words "if any" as surplusage, or as being an abbreviation for the words "if any dispute arises". Any other construction appears to me to strain common sense and to breach the overall rule of construction which is to give effect to the presumed intention of the parties having regard to the context in which the words appear."

Likewise, in the Canadian case of *Onex Corp. v. Ball Corp*., [1994] 12 B.L.R. (2nd) 151, the Ontario Court had to consider whether a dispute between parties to a complex joint venture agreement concerning rectification of a contractual term ought to be submitted to the courts or to arbitration. Blair J. referred the dispute to arbitration and stayed the court action despite the ambiguity in the relevant clause observing at page 160 of his judgement that, "where the language of the arbitration clause is capable of bearing two interpretations, and only one of those interpretations fairly provides for arbitration, the courts should lean towards honouring that option". In *Star Shipping AS v. China National Foreign Trade Transportation Corporation* [1993] 2 Lloyd's Reports 445, the English Court of Appeal was called upon to determine the validity of an arbitration clause contained in Clause 35 of a charter party. The arbitration clause provided that "any dispute arising under the charter is to be referred to arbitration in Beijing or London in the defendant's option." It was argued that the arbitration clause was ambiguous, uncertain and one sided. The Court of Appeal held that the clause was a valid arbitration clause. Lloyd, L.J. emphatically stated at page 449 that despite the ambiguity of the clause, "the one thing that is clear about Clause 35 is that the parties intended to refer their dispute to arbitration. I would be very reluctant indeed to defeat that intention." In these and other cases, the courts have consistently given effect to the spirit of the arbitration agreements in question to refer disputes to arbitration. Clause 14 of the Franchise Agreement, which comes up for interpretation in this case, clearly manifests the consent of the parties to refer the dispute for arbitration, and is neither ambiguous nor capable of bearing two interpretations. The clause, in unequivocal terms refers any dispute that may arise from the said Agreement to arbitration, and that it is a clear and unambiguous manifestation of consent of the parties to resort to arbitration.

The question then is whether the agreement to refer any dispute for arbitration, has been frustrated by physical impossibility in that the intended arbitral forum does not exist. Learned Counsel for the Respondent has specifically admitted that there is no entity in existence in Sri Lanka known as 'the Sri Lanka Chamber of Commerce and Industry, Colombo', but has submitted with great force that this fact would not affect the validity of the arbitration agreement contained in Clause 14 of the Franchise Agreement. He has submitted that the essence of an arbitration clause or submission agreement is the intention manifested therein to refer the matter for arbitration, but an express provision naming the arbitrator or arbitrators or setting out some procedure for the constitution of an arbitral tribunal is not an essential element of an agreement to arbitrate.

The Arbitration Act of 1995 contains elaborate provisions to deal with the myriads of difficulties that could arise in constituting the arbitral tribunal, including the very situation that arose in this case. The Arbitration Act contains many provisions which give effect to the concept of party autonomy, which pervades the law of arbitration, and foremost amongst them are the provisions which enable the parties to choose their arbitrator or arbitrators, taking into consideration *inter alia* their special expertise in the relevant field, ability and integrity.

The composition of the arbitral tribunal with expedition is indeed critical for the success of any arbitration, and in this context, it is necessary to mention that the distinction between institutional arbitration and *ad hoc* arbitration is of some significance. Institutional rules such as those of the ICC, the AAA, and the LCIA, generally provide that where the mechanism agreed by the parties for the appointment of arbitrators does not produce results, the appointing authority of the institution to which those rules belong will act as the default authority and make the required appointment. However, where the relevant institutional rules do not provide an effective default mechanism, or in the case of *ad hoc* arbitration, courts have a role to play in the constitution of the arbitral tribunal, particularly where there are no statutory provisions to assist the parties to constitute the arbitral tribunal. Fortunately, most countries have legislative provisions which enjoin the court to facilitate the process of constituting the arbitral tribunal, and in Sri Lanka specific and elaborate provisions in this regard are found in Section 7 of the Arbitration Act of 1995. Resort to such legislative provisions will certainly prevent arbitration proceedings from being frustrated by the lack of an effective mechanism to set up the tribunal, and in the face of such elaborate legal provisions, it is not possible to sustain the argument that the agreement to arbitrate was frustrated by physical impossibility.

Accordingly, and for the above reasons, the first question of law on which leave to appeal was granted is answered in the affirmative. I hold that the Commercial High Court misdirected itself in holding the arbitration agreement contained in Clause 14 of the Franchise Agreement was void *ab initio.* I also hold that in the circumstances of this case, the Commercial High Court had no jurisdiction to hear and determine the subject matter of the action from which this appeal arises, as the Appellant has objected to the court exercising jurisdiction in respect of such matter.

Obligation to determine dispute by arbitration

The next question arising on this appeal is whether the Commercial High Court erred in law in ignoring Section 4 of the Arbitration Act of 1995. This provision reads as follows:-

> "Any dispute which the parties have *agreed to submit to arbitration* under an arbitration agreement *may* be determined by arbitration unless the matter in respect of which the arbitration agreement is entered into is contrary to public policy or, is not capable of determination by arbitration." (*emphasis added*)

There is no doubt that considerations of public policy and arbitrability will militate against the enforcement of an otherwise valid agreement to arbitrate. The dynamism inherent in these interrelated concepts has provided the law with some amount of flexibility, while at the same time creating a great deal of uncertainty, as the content of public policy as well as the parameters of arbitrability keep changing from country to country and from time to time. Recent decisions reveal a global trend of liberalizing the scope of objective arbitrability in areas such as insolvency (*See, SONATRACH v Distrigas* 80 BR 606 (D. Mass. 1987) anti-trust claims (*See, Mitsubishi Motors Corp. v. Soler Chrysler Plymouth Inc*. [1985] 473 U. S. 614. *Cf., Eco Swiss China Time Ltd v. Benetton International N.V.,* 1999 E.C.R. I-3055; *ET Plus S.A. v. Jean-Paul Welter & The Channel Tunnel Group Ltd.* [2005] EWHC 2115 (Comm.) and securities claims (*See, Rodriguez de Quijas v. Shearson/American Express* 490 US 477 (1989); *Cf., Philip Alexander Securities v Bamberger* [1997] EULR 63 (1996) CLC (1) 757), but this cannot undermine the value of these concepts, which encompass "fundamental principles of law and justice in substantive as well as procedural aspects" (*per* ShiraneeTilakawardane, J. in *Light Weight Body Armour Ltd., v Sri Lanka Army* [2007] BALR 10 at page 13).

However, the important question that arises in this context is whether the word "may", as used in Section 4, makes it mandatory for any dispute which the parties have agreed to refer for arbitration, has necessarily to be determined through arbitration, if the matter is not contrary to public policy and is capable of being resolved by arbitration. The "may" and "shall" dichotomy has oft confounded courts in the process of statutory interpretation, and as N.S.Bindra's Interpretation of Statutes (10th Edition, Butterworths, 2007) explains at page 999-

> The use of the expression "may" or "shall" in a statute is not decisive, and other relevant provisions that can throw light have to be looked into in order to find out whether the character of the provision is mandatory or directory. In such a case legislative intent has to be determined. The words "may", "shall", "must" and the like, as employed in statutes, will in cases of doubt, require examination in their particular context in order to ascertain their real meaning.

In ascertaining the legislative intent, it is permissible to look at the purpose of the legislation in which the particular provision sought to be interpreted occurs. Learned Counsel for the Appellant has referred us to the preamble to the Arbitration Act which, *inter alia* states that one of the main objects of the legislation was to "give effect to the principles of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (Done at New York, 10 June 1958; Entered into force, 7 June 1959 330 U.N.T.S. 38 (1959) also know as the "New York Convention").. ……and to provide for matters connected therewith or incidental thereto". In this connection, he has also invited the attention of Court to Article II paragraph 1 of the said Convention, which provides that-

> "Each Contracting State *shall* recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration".*(emphasis added)*

While this Court has authoritatively held that in view of the dualist as opposed to monist character of the Sri Lankan legal system, no international convention or treaty is binding on a Sri Lankan court unless incorporated by implementing legislation (*See, Nallaratnam Singarasa v. Attorney General* SC Spl. (LA) No.182/99 SC Minutes dated 15.9.2006 available at: http://www.alrc.net/doc/mainfile.php/supremecourtcases/423/), this Court has in *Sunila Abeysekera v Ariya Rubasinghe, Competent Authority and Others* [2000] 1 Sri LR 314 at page 353 observed, that-

> "It is within the proper nature of the judicial process and well-established judicial functions for national courts to have regard to international obligations which a country undertakes - whether or not they have been incorporated into domestic law - for the purpose of removing ambiguity or uncertainly from national constitutions, regulation or common law."

While it axiomatic that in interpreting the provisions of the Arbitration Act, this Court has to bear in mind the national obligation cast on Sri Lanka by the above provision of the Convention, and the Court has to lean in favour of giving effect to the arbitration clause contained in Clause 14 of the Franchise Agreement despite its erroneous assumption that the institution named in the clause existed and was capable of functioning as an arbitration centre or facilitator of arbitration, it is also imperative that this Court does not lose sight of the statutory context in which Section 4 occurs in the Arbitration Act. Section 4 has to be read in conjunction with Section 5 of the said Act, which consistently with the concept of 'party autonomy', expressly confers on every party to an arbitration agreement the right to decide whether or not to object to the jurisdiction of a court where the same is invoked by the other party to the agreement. Where a party to such an agreement decides not to take up any objection to the exercise of jurisdiction by court, it is free to hear and determine the case or other proceeding, and in such as case Section 4 clearly would not make it mandatory for the matter to be determined by arbitration. However, in the action from which this appeal arises, the Appellant had in fact specifically objected to the exercise of jurisdiction by the Commercial High Court, and since there was no question of public policy or arbitrability involved, the said court had in my opinion erred in law in failing to give effect to the intent of Section 4 of the Arbitration Act.

Accordingly, I hold that the second substantive question on which leave to appeal has been granted by this Court should also be answered in the affirmative and against the Respondent.

Procedure for the appointment of an Arbitral Tribunal

This brings me to the next question on which leave has been granted by this Court, namely, whether the Commercial High Court erred in law in failing to apply the provisions of the Arbitration Act, and in particular Section 7 thereof, which provides for the appointment of the arbitrators in terms of the provisions thereof in the absence of agreement between the parties for the appointment of arbitrators. Section 7 provides as follows:

> 7. (1) The parties shall be free to agree on a procedure for appointing the arbitrators, subject to the provisions of this Act.
>
> (2) In the absence of such agreement-
>
> (a) in an arbitration with a sole arbitrator if the parties are unable to agree on the arbitrator, that arbitrator shall be appointed, on the application of a party by the High Court;
>
> (b) in an arbitration with three arbitrators, each party shall appoint one arbitrator, and the two arbitrators thus appointed shall appoint the third arbitrator; if a party fails to appoint the arbitrator within sixty days of receipt of a request to do so from the other party, or if the two arbitrators fail to agree on the third arbitrator within sixty days of their appointment, the appointment shall be made, upon the application of a party, by the High Court**.**
>
> (3) Where, under an appointment procedure agreed upon by the parties –

(a) a party fails to act as required under such procedure ; or

(b) the parties, or the arbitrators, are unable to reach an agreement required of them under such procedure ; or

(c) a third party, including an institution, fails to perform any function assigned to such third party under such procedure,

any party may apply to the High Court to take necessary measures towards the appointment of the arbitrator or arbitrators,

(4) The High Court shall in appointing an arbitrator, have due regard to any qualifications required of an arbitrator under the agreement between the parties and to such considerations as are likely to secure the appointment of an independent and impartial arbitrator.

Learned Counsel for the Appellant has invited the attention of Court to the preamble to the Arbitration Act which *inter alia* describes it as an Act "to make *comprehensive* legal provision for the conduct of arbitration proceedings and the enforcement of awards made there under". He has submitted that Section 7(1) of the Arbitration Act allows the parties to agree on a procedure for the appointment of arbitrators, and the remaining subsections of that Section set out the procedure for the appointment of an arbitrator where the parties have not agreed upon any procedure, or the agreed procedure fails for some reason or the other. Insofar as Clause 14 the Sri Lanka Chamber of Commerce and Industry, Colombo, specified in the said Clause as the institution to which the arbitration should be referred for arbitration, admittedly does not exist, and the said Clause or any other clause of the Franchise Agreement does not set out any other default authority for appointment of arbitrators or even specify the number of arbitrators to be appointed to the tribunal, it will in his submission be necessary to call in aid Section 6(2) of the Arbitration Act of 1995 which expressly provides that where the parties have not determined the number of arbitrators before whom arbitration proceedings should take place, "the number of arbitrators shall be three."

Cause 14 of the Franchise Agreement merely seeks to specify an arbitral institution without setting out a default procedure for the appointment of arbitrators. Thus, in the absence of a mutually agreed procedure for appointing arbitrators, the case clearly falls within the ambit Section 7(2) (b) of the Arbitration Act, in terms of which the parties themselves can nominate one arbitrator each and the two arbitrators will thereafter appoint the third arbitrator. If a party fails to appoint an arbitrator within the time limit specified in that time period, or the two party appointed arbitrators fail to reach agreement in regard to the appointment of the third arbitrator, the relevant appointment has to be made by the High Court.

Learned Counsel for the Respondent has of course argued, as already noted, that the non-existence of the arbitral institution specified in Clause 14 of the Franchise Agreement essentially frustrates it and renders compliance with the arbitration clause impossible. For the reasons already set out earlier in the judgement, this Court is not persuaded by this submission, and the said submission cannot stand in the face of the abovementioned provisions of the Arbitration Act, which directly apply and have in fact anticipated the very problem that had arisen in this case. It is indeed a pity that the Commercial High Court has not considered these provisions which have the beneficial effect of curing any frustrating circumstances that could arise or supervene in regard to the constitution of the arbitral tribunal.

Thus the third substantive question of law argued on this appeal, necessarily has to be answered in the affirmative. I hold that the High Court has misdirected itself by failing to consider the

provisions of Section 7 of the Arbitration Act in deciding that the arbitration agreement has been rendered void by reason of frustration due solely to the non-existence of the named arbitral institution.

Should action be dismissed or proceedings stayed?

Since all the three substantive questions on which leave to appeal has been granted by this Court have been answered in the affirmative, the judgement of the Commercial High Court dated 7th October 2008 upholding the preliminary objections taken by the Appellant based on issues 1, 2, 3, 8 and 10 has to be set aside. The Commercial High Court clearly had no jurisdiction to hear and determine the case on its merits, but a question of fundamental importance that arose in the course of the argument of this appeal, as to whether in such a situation, the action filed by the Respondent should be dismissed, or only stayed, has to be dealt with. In fact, at the conclusion of oral submissions on 30th June 2009, learned Counsel for both parties were granted further time to file further written submissions specifically on this question.

In this context, it is necessary to refer once again to Section 5 of the Arbitration Act of 1995, which provides 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." It is important to note that Section 5 does not expressly provide that, in that situation, the action shall be dismissed or alternatively that proceedings shall be stayed. Learned Counsel for the Appellant has sought to contrast Section 5 of our Act with Article II paragraph 3 of the New York Convention and Article 8(1) of the UNCITRAL Model Law on International Commercial Arbitration, which he submits, contemplated the stay or laying by of the action or proceedings until the conclusion of the arbitration.

Both the said Convention and the Model Law have had considerable influence in the legislation enacted all over the world, and almost all countries have expressly opted to provide for some form of stay of court proceedings until the dispute is resolved by arbitration. For instance, Section 9 of the English Arbitration Act of 1996, expressly provides that a party to an arbitration agreement against whom legal proceedings are brought in respect of a matter which under the agreement is to be referred to arbitration *may* apply to the court in which the proceedings have been brought, to stay the proceedings so far as they are concerned, and when such a party opts to apply for a stay of proceedings, it is expressly provided in Section 9(4) that "the court *shall grant a stay* unless satisfied that the arbitration agreement is null and void, inoperative, or incapable of being performed."

Learned Counsel for the Appellant has contended that the Sri Lankan legislature has departed from the formulation of Article II paragraph 3 of the New York Convention, and the procedure expressly adopted in most jurisdictions which have based their legislation on the UNCITRAL Model Law. He has submitted, with great force, that such departure cannot be unintentional, and that since the Sri Lankan provision does not expressly provide for a stay of proceedings, the action should necessarily be dismissed for lack of jurisdiction. He argues that when a court has no jurisdiction, it can proceed no further in respect of the matter, and has cited the decision of this Court in *P. Beatrice Perera v. Commissioner of National Housing and Three Others*, 77 NLR 361 for this proposition.

Learned Counsel for the Respondent has stressed that Section 5 of the Arbitration Act of 1995 does not expressly provide that the action should be dismissed, and that the court has a discretion under its inherent power, which has been expressly preserved by Section 839 of the Civil Procedure Code "to make such orders as may be necessary for the ends of justice or to prevent

abuse of the process of the court" which includes an order for stay of proceedings in the action short of dismissal. He contends that there is nothing in Section 5 that takes away the power of court to stay proceedings in appropriate cases.

It appears to me that while the language of Section 5 of the Arbitration Act of 1995 manifests a clear intention to depart from the imperative language adopted by the English Arbitration Act of requiring a stay of proceedings which is emphasized by the use of the words "*shall* grant a stay" in the English provision, it was clearly not intended to depart from the New York Convention and UNCITRAL Model Law provisions. Article II paragraph 3 of the New York Convention is rather neutral in regard to the sanction of dismissal / stay of action, and simply provides that-

> "The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, at the request of one of the parties, *refer the parties to arbitration*, unless it finds that the said agreement is null and void, inoperative or incapable of being performed." *(emphasis added)*

The words "refer the parties to arbitration" as used in the Convention seem to permit the national legislature of each contracting State to decide what sanctions should be imposed where the agreement to arbitrate is not adhered to by a party to such agreement. Similarly, Article 8 of the UNCITRAL Model Law provides as follows:

> "1. A court before which an action is brought in a matter which is the subject of an arbitration agreement *shall*, if a party so requests not later than when submitting his first statement on the substance of the dispute, *refer the parties to arbitration* unless it finds that the agreement is null and void, inoperative or incapable of being performed.
>
> 2. Where an action referred to in paragraph (1) of this article has been brought, arbitral proceedings may nevertheless be commenced or continued, and an award may be made, while the issue is *pending before the court.*"*(emphasis added)*

Here again, the formula uses the neutral words "refer the parties to arbitration", which are not conclusive in regard to whether the action or other proceeding commenced by the party to the arbitration agreement should be dismissed or merely stayed. Paragraph 2 of the UNCITRAL Model Law, clearly envisages a situation where notwithstanding the agreement to arbitrate and the reference by the court of the parties to arbitration, the action or proceedings commenced in court is kept pending.

The question then is whether the neutrality in regard to sanction found in the New York Convention and the UNCITRAL Model Law has been preserved in Section 5 of the Arbitration Act? A careful reading of Section 5 of the Arbitration Act would reveal that it merely provides that "the Court *shall have no jurisdiction to hear and determine such matter*", but it does not take away the power of court in appropriate circumstances of making other orders supportive of or incidental to the arbitral process, such as for the constitution of the arbitral tribunal or for providing such interim measures as may be necessary to protect or secure the claim which forms the subject matter of the arbitration agreement. Section 5 of the Act also falls short of requiring that, a court that is confronted with an agreement to arbitrate the dispute, should invariably dismiss the action or terminate any other court proceedings that may have been commenced. In my view, the Commercial High Court enjoyed the inherent power of court, which has been expressly preserved by Section 839 of the Civil Procedure Code, to decide at its discretion whether to dismiss action or stay proceedings, in the absence of any express and clear words in Section 5 or any other provision of the Arbitration Act or any other applicable legislative provision which purported to take away that discretion.

In this context, it is of some significance to note that Section 7 of the Arbitration Ordinance No. 15 of 1866, as subsequently amended, expressly provided that where a party to an agreement to arbitrate, nevertheless commenced any action against the other party to the said agreement, "*it shall be lawful for the court* in which the action is brought, on application by the defendants, or any of them, upon being satisfied that no sufficient reason exists why such matters cannot be referred to arbitration according to such agreement as aforesaid,……*to make an order staying all proceedings in such action, and compelling reference to arbitration on such terms as to costs and otherwise as to such court may seem fit*." This provision is no more in force in Sri Lanka as the Arbitration Ordinance, in its entirety, has been now repealed by Section 47(1) of the Arbitration Act of 1995, and replaced by Section 5 of the latter Act.

When interpreting a statutory provision, a court is entitled to take into consideration the law that existed prior to the enactment of such statutory provision. Section 5 of the Arbitration Act does not contain any words that manifest an intention to take away the discretion the court had prior to the enactment of that section. On the contrary, the words used in Section 5 are neutral and are in line with Article 8 of the UNCITRAL Model Law and consistent with the provisions of the New York Convention. I therefore hold that the Commercial High Court had the power to dismiss the action or stay proceedings, for the purpose of giving effect to Section 5 of the Arbitration Act.

In my opinion, the discretion to decide whether to dismiss an action or stay proceedings has to be exercised after carefully considering the facts and circumstances of each case. Of course, the pre-1995 law provided for the filing of an agreement to arbitrate in the District Court (Section 693(1) of the Civil Procedure Code, which was empowered to nominate the arbitrator, if the parties cannot agree on an arbitrator (Section 694 of the Civil Procedure Code) and also to file and enforce the ensuing arbitral award (Sections 696 to 698 read with Section 692 of the Civil Procedure Code), and it would have made sense to stay proceedings as contemplated by Section 7 of the Arbitration Ordinance in the large majority of cases filed in the District Court, as the ultimate award had to be filed in the same court for it to be enforced.

However, in this context, it is necessary to mention that the situation is not the same in Sri Lanka at present, as Sections 693 to 698 of the Civil Procedure Code have been repealed by Section 47(2) of the Arbitration Act of 1995. The resulting position is that, the Commercial High Court, which was constituted by an order made under Section 2(1) of the High Court of the Provinces (Special Provisions) Act No. 10 of 1996, and before which this case was taken up for trial, is not the same High Court that is vested with the default authority to take measures for the appointment of arbitrators under Section 7 of the Arbitration Act of 1995 and to enforce arbitral awards under Section 31 of the said Act. The default appointing authority and enforcement court for purposes of the Arbitration Act is the High Court that is defined in Section 50 of the Arbitration Act as the "High Court of Sri Lanka, holden in the judicial zone of Colombo or holden in such other zone, as may be, designated by the Minister with the concurrence of the Chief Justice, by Order published in the Gazette." This is probably why, Parliament, in its wisdom, did not expressly provide in Section 5 of the Arbitration Act whether the action should be dismissed or merely stayed, but left it open for the court to consider what order, apart from referring the parties to proceed to arbitrate their dispute, should be made in regard to the fate of the action in the context of which the order is being made.

Of course, the vast majority of cases would be those in which it is obvious that no useful purpose would be served by staying proceedings, and a court will in the normal course dismiss the action or terminate proceedings. There can also be a few cases in which a court would readily stay proceedings, as opposed to dismissing the action or other proceeding, such as for instance, where an action has been filed on several causes of action and not all of them fall within the purview of

the agreement to arbitrate. Between these two extremes, there can be a great variety of cases in which the decision as to whether action should be dismissed or stayed will not be easy to make. In some of these cases, particularly where there is an international element, it may well be that there are concurrent judicial and or arbitral proceedings in more than one jurisdiction, and cogent reasons may be advanced to justify the continuation of such proceedings, but in making its decision, a court will also take into consideration the need to avoid multiplicity of proceedings with the accompanying risk of inconsistent judgements and arbitral awards. Many principles have been evolved by the courts all over the world to deal with such issues of great variety and complexity. Apart from such issues, difficult questions could also arise in regard to public policy and arbitrability, which have the potentiality of rendering the arbitration agreement and / or the ensuing arbitral award unenforceable, a factor which should be taken into consideration in deciding whether an action should merely be stayed or dismissed.

The court is not only entitled but also obliged to consider all material circumstances of the relevant action or proceeding and the issues they give rise to when determining whether the action or other proceeding should be stayed or dismissed. In my considered view, since in the vast majority of cases, no purpose can be served by keeping an action or other proceeding which the court has no jurisdiction to hear and determine pending before it, the action should be dismissed or other proceedings terminated, unless there are justifiable grounds for ordering that the action should be stayed. However, in the case at hand, the Respondent has not formally moved court for a stay of proceedings or furnished any material that could justify an order for the stay of the action from which this appeal arises, nor has learned Counsel adverted in his written submissions or in the course of oral submissions to any facts or circumstances that could justify an order staying the action. Although this Court may *ex mero motu* take note of any matter that could involve an issue of public policy or arbitrability, none has come up for consideration in the course of the hearing on this appeal. There does not appear to be any justification for staying the action which forms the subject matter of this appeal, and as such, I am of the opinion that the action filed by the Respondent in the Commercial High Court should stand dismissed.

Conclusions

For the foregoing reasons, this appeal is accordingly allowed and the order of the learned High Court Judge dated 7th October 2008 set aside. The action filed in the Commercial High Court by the Plaintiff-Respondent-Respondent will stand dismissed. This Court does not make an order for costs in all the circumstances of this case.

JUDGE OF THE SUPREME COURT

P.A. RATNAYAKE, J.

I agree.

JUDGE OF THE SUPREME COURT

S.I. IMAM, J.

I agree.

JUDGE OF THE SUPREME COURT