



## ELP Arbitration: Update



### A SEASON OF REFERENCES TO THE LARGER BENCH OF THE SUPREME COURT

#### INTRODUCTION

Given the conflicting decisions on certain issues in relation to the Arbitration and Conciliation Act, 1996 (**Act**), recently notable references have been made to larger benches of the apex court. On January 11, 2021, the Supreme Court, in two separate matters, referred the below questions to its larger bench -

- Whether the statutory bar contained in Section 35 of the Indian Stamp Act, 1899 applicable to instruments chargeable to Stamp Duty under Section 3 read with the Schedule to the act, would also render the arbitration agreement contained in such an instrument, which is not chargeable to payment of stamp duty, as being non-existent, unenforceable, or invalid, pending payment of stamp duty on the substantive contract/instrument? (Reference-1)
- Whether the judgment of the apex court in *Central Organisation for Railway Electrification V. ECI-SPIC-SMO-MCML (JV) A Joint Venture Company*, 2019 SCC OnLine 1635 is correct? i.e. whether the appointment of an arbitrator by a person who is ineligible to act as an arbitrator under section 12 (5) of the Act, is valid? (Reference-2)

#### REFERENCE-1

- In *NN Mercantile*<sup>1</sup>, the Supreme Court held that non-payment of stamp duty on the commercial contract containing the arbitration agreement would not render the arbitration agreement invalid, non-existent in law and unenforceable. Thus, the Supreme Court overruled *SMS Tea Estates*<sup>2</sup> and in doing so, it has taken a different view from a recent decision of its coordinate bench in *Vidya Drolia*<sup>3</sup>. Owing to the conflicting decisions, the Supreme Court has made a reference to a constitution bench of the Supreme Court comprising of five judges to determine Reference-1.

<sup>1</sup> *N.N. Global Mercantile Pvt. Ltd. v. Indo Unique Flame Ltd and Ors.*, 2021 SCC OnLine SC 13;

<sup>2</sup> *SMS Tea Estates (P) Ltd. v. Chandmari Tea Co. (P) Ltd.*, (2011) 14 SCC 66;

In *SMS Tea Estates*, the Supreme Court *inter alia* held that if an arbitration clause is contained in a document which is not duly stamped, such an arbitration clause cannot be acted upon. Further, the Supreme Court held that while hearing an application under section 11 of the Arbitration and Conciliation Act, 1996, the judge must first impound such document and only once the defect with respect to the stamp duty is cured, the court shall proceed further with the application.

<sup>3</sup> *Vidya Drolia and Others v. Durga Trading Corporation*, 2020 SCC OnLine SC 1018;

## FACTS AND FINDINGS

- Indo Unique Flame Ltd. (**IUFL**) was awarded a work order (**Principal Contract**) from Karnataka Power Corporation Ltd. (**KPCL**). Thereafter, IUFL appointed a sub-contractor, and IUFL and N.N. Global Mercantile Pvt. Ltd. (**GMPL**) entered into a work order dated 28 September 2015 for transportation of coal to a site (**Contract**) which contained the arbitration agreement. Pursuant to the Contract, GMPL furnished a bank guarantee in favor of the banker of IUFL (**BG**). When disputes arose between IUFL and KPCL, on 7 December 2017, IUFL invoked the BG.
- Aggrieved by the invocation of the BG, GMPL filed a suit against IUFL and its banker before the Commercial Court, Nagpur (**Commercial Court**) contesting the invocation and raising allegations of fraud. In light of the arbitration clause in the Contract, IUFL filed an application under section 8 (**Section 8 Application**) of the Act seeking reference of disputes to arbitration. By an Order dated 18 January 2018, the Commercial Court held in favor of GMPL and observed that the arbitration clause in the Contract did not extend to the BG and therefore the Section 8 Application was not maintainable (**CC Order**).
- Aggrieved by the CC Order, IUFL filed a writ petition (**Writ Petition**) before the Bombay High Court (**High Court**) and sought to set aside the CC Order. By an Order dated 30 September 2020 (**HC Order**), the High Court held that (i) the Section 8 Application was maintainable in view of the arbitration agreement between the parties; (ii) the issue of fraud could be resolved by arbitration; (iii) the Commercial Court was not justified in restraining the invocation of the BG in the absence of any finding on fraud; and (iv) the question of whether the arbitration agreement was unenforceable since the Contract was unstamped could be raised either in an application under section 11 of the Act or before the tribunal at the appropriate stage.
- Aggrieved by the HC Order, GMPL filed a special leave petition before the Supreme Court. The Supreme Court examined the submissions, jurisprudence, and evolution of statutory provisions to arrive at its findings. While other issues arose for consideration (i.e. whether the allegations of fraud are arbitrable and whether the Writ Petition is maintainable), the Supreme Court's findings relevant to Reference-1 (i.e. whether the arbitration agreement is enforceable even if the Contract is unstamped/unenforceable under the Stamp Act?), are *inter alia* summarized below:
  - Under the Maharashtra Stamp Act, 1958 (**Maha Stamp Act**), an arbitration agreement is not listed in the schedule as an instrument chargeable to stamp duty. Section 3 of the Maha Stamp Act does not subject an arbitration agreement to payment of stamp duty.
  - Non-payment of or deficiency of stamp duty on the Contract does not invalidate the main contract.
  - While the adjudication of rights and obligations of the main contract cannot proceed before complying with the mandatory provisions of the Maha Stamp Act, there is no legal impediment to the enforceability of the arbitration agreement, pending payment of stamp duty on the main contract.
  - Based on the principle of separability, the arbitration agreement is an independent agreement.
  - As the arbitration agreement is not chargeable to payment of stamp duty, non-payment of stamp duty on the commercial contract containing the arbitration agreement would not be rendered the arbitration agreement invalid, non-existent in law and unenforceable.
  - The decision in *SMS Tea Estates* is overruled.
  - *Garware Wall Ropes Ltd.*<sup>4</sup> has followed *SMS Tea Estates*; at paragraph 92, the Supreme Court in *Vidya Drolia*<sup>5</sup> has followed and affirmed para 22 and 29 of *Garware Wall Ropes*. The correctness of the said paragraph in *Vidya Drolia* is therefore doubted.
  - In view of the above, the Supreme Court made Reference-1.

## REFERENCE-2

- In *Tantia Constructions*<sup>6</sup>, while the Supreme Court did not interfere with the judgment of the high court under section 11 of the Act and dismissed the special leave petition filed before it, it doubted the correctness of the three-judge

<sup>4</sup> *Garware Wall Ropes Ltd. v. Coastal Marine Constructions & Engineering Ltd.*, Civil Appeal No. 3631 of 2019 arising out of Special Leave Petition (Civil) No. 9213 of 2018

<sup>5</sup> *Vidya Drolia and Others v. Durga Trading Corporation*, 2020 SCC OnLine SC 1018;

<sup>6</sup> *Union of India v. M/s Tantia Constructions Ltd.*, Petition(s) for Special Leave to Appeal (C) No(s). 12670/2020 (Arising out of impugned final judgment and order dated 12-03-2020 in AP No. 732/2018 passed by the High Court at Calcutta)

bench in *Central Organisation*<sup>7</sup> that was being relied upon by one of the parties. Commenting on *Central Organisation*, the Supreme observed that *once the appointing authority itself is incapacitated from referring the matter to arbitration, it does not then follow that notwithstanding this, yet appointments may be valid depending on the facts of the case*. The apex court has therefore made Reference-2 to the larger bench.

- By way of background, in *Perkins Eastman*<sup>8</sup> the Supreme Court had extended the dictum<sup>9</sup> of its own decision in *TRF Limited*<sup>10</sup> to state that a person having an interest in the outcome or decision of the dispute must not have the power to appoint the sole arbitrator. It was further held by the Supreme Court that where only one party had the right to appoint a sole arbitrator, such party's choice will always have an element of exclusivity in determining or charting out the course of dispute resolution. As such the Supreme Court had struck down a clause that permitted a party to unilaterally appoint an arbitrator. In *Central Organisation*, upon examining an arbitration agreement that permitted one party to recommend a panel of arbitrators from which the other party could pick one, the Supreme Court seemed to have applied the reasoning in *TRF Limited and Perkins Eastman* to uphold the arbitration clause, stating that where both parties have a right to nominate their respective arbitrators, any advantage to one party which nominates an arbitrator of its choice gets counter balanced by an equal power with the other party. In the words of the Supreme Court, *right of the General Manager in formation of Arbitral Tribunal is counter-balanced by respondent's power to choose any two from out of the four names and the General Manager shall appoint at least one out of them as the contractor's nominee*. This reasoning enabled the Supreme Court to uphold the arbitration clause despite the possibility that the panel from which said party was to choose the arbitrator was itself selected unilaterally by the other party. For our detailed analysis on the decisions in *Perkins Eastman* and *Central Railways*, please click [here](#) and [here](#).
- In *Tantia Constructions*, despite a similar arbitration clause to that in *Central Railways*, the Supreme Court refused to interfere in the high court's decision to appoint an arbitrator de hors the arbitration clause. The Supreme Court disagreed with its own decision in *Central Railways* and recognized the need for the same to be decided by a larger bench.

## CONCLUSION AND ANALYSIS

- Undoubtedly, the references will clear the muddled water and perhaps even usher in the appropriate position in law, but we cannot ignore that the string of conflicting decisions leading up to the references is slowly portraying a landscape of uncertainty regarding the law of arbitration in India. There are still burning issues that ought to be finally determined by the apex court including the question of whether two Indian parties can choose a foreign seat of arbitration. Other potential but yet unseen conflicts include those around the court's precise ambit under section 11, more so given the recent deletion of section 11(6-A) that was introduced by the 2015 Amendment Act. For litigants, there is a constant risk that the judicial precedents that are good law today may be upended with the passage of time. Changing views and law are inevitable, however, it is imperative that India moves towards creating an investor friendly and pro arbitration environment that offers reliability and efficiency.
- In light of Reference-1 and Reference-2, ongoing proceedings wherein the same contention has been raised may now witness some necessary delay until the references are decided. Nonetheless, the references are a step in the right direction as they will conclusively settle the issues in question, and will bring much needed clarity at a time when the Arbitration and Conciliation (Amendment) Act, 2019 is being ushered into active implementation.

**Disclaimer:** The information provided in this update is intended for informational purposes only and does not constitute legal opinion or advice

<sup>7</sup> *Central Organisation for Railway Electrification V. ECI-SPIC-SMO-MCML (JV) A Joint Venture Company*, 2019 SCC OnLine 1635

<sup>8</sup> *Perkins Eastman Architects DPC v. HSCC (India) Limited*, 2019 SCC OnLine SC 1517

A petition filed under Section 11 of the Act was filed by a consortium before the SC seeking appointment of a sole arbitrator. Pertinently, in terms of the applicable arbitration clause, the respondent's Managing Director was to unilaterally appoint a sole arbitrator of his choice and accordingly, a sole arbitrator had already been appointed by the Respondent.

<sup>9</sup> That once the named arbitrator has become ineligible by operation of law, he cannot nominate another as an arbitrator

<sup>10</sup> *TRF Limited v. Energo Engineering Projects Limited*, (2017) 8 SCC 377