



ELP Arbitration: Update



Scope of intervention by the Courts under Section 11(6) of the Arbitration Act - Evaluating through the 'Eye of the Needle'

In *NTPC Ltd. v. SPML Infra Ltd.*¹, the Supreme Court of India (**Supreme Court**) addressed the scope of intervention of the high courts under Section 11 (6) of the Arbitration and Conciliation Act, 1996 (**Arbitration Act**), including the role of the court in examining arbitrability of disputes.

Background

Disputes arose between NTPC Ltd. (**NTPC**) and SPML Infra Ltd. (**SPML**) from a contract for installation services at a thermal power project. Upon completion of the project, although NTPC released the final payment, it withheld the Bank Guarantees issued by SPML on account of disputes that had arisen under other projects. SPML filed a Writ Petition², before the High Court of Delhi (**Delhi HC**) seeking release of the bank guarantees. While the Writ Petition was pending, NTPC and SPML entered into a Settlement Agreement (**Settlement Agreement**). Pursuant to the Settlement Agreement, NTPC released the bank guarantees and SPML withdrew the Writ Petition.

Shortly thereafter, SPML repudiated the Settlement Agreement and filed an application under Section 11 (6) of the Arbitration Act before the Delhi HC seeking court assistance to constitute the arbitral tribunal. While SPML alleged that it was coerced into executing the Settlement Agreement, NTPC contended that the contract was discharged/ novated in terms of the Settlement Agreement. The Delhi HC observed that - it would be difficult for SPML to establish coercion. Nonetheless, once an arbitration agreement was entered into, the question of whether the contract stood discharged/novated must be answered without a detailed adjudicatory exercise. Unless the court concludes that the disputes are frivolous, parties must have their say before the agreed forum. In the circumstances, the Delhi HC allowed the application. Aggrieved by the order, NTPC approached the Supreme Court.

Key Findings of the Court

Threshold for interference by the courts when questions of arbitrability surface

The Supreme Court traced the judicial and legislative journey *vis-à-vis* the pre-referral jurisdiction of the High Courts under Section 11 of the Arbitration Act, particularly when questions of arbitrability surfaced at the stage of constitution of the arbitral tribunal.

- In *Boghara Polyfab*³, the apex court held that the issue of non-arbitrability of a dispute will have to be examined by the court in cases where accord and discharge of the contract is alleged. With respect to applications wherein allegations of fraud/coercion had arisen, the apex court has held that - if a no claim certificate/settlement agreement

¹ 2023 SCC OnLine SC 389.

² Writ Petition No. 7213 of 2019, under Article 226 of the Constitution of India.

³ *National Insurance Co. Ltd. v. Boghara Polyfab (P) Ltd.*, (2009) 1 SCC 267.

is alleged to be obtained by fraud / coercion, then the court must *prima facie* examine the credibility of the allegations⁴; and a party alleging fraud or coercion or undue influence, must substantiate the same with evidence⁵.

- Section 11 (6-A), as inserted through the Arbitration and Conciliation (Amendment) Act, 2015 provided that the court must “confine to the examination of the existence of an arbitration agreement”. Following the amendment, in *Duro Felguera*⁶, the apex court held that the jurisdiction of the court under Section 11(6) of the Arbitration Act is limited to examining whether an arbitration agreement exists between the parties - “nothing more, nothing less”. Then, in *Mayavati Trading*⁷, it observed that “section 11(6-A) is confined to the examination of the existence of an arbitration agreement and is to be understood in the narrow sense as has been laid down in the judgment in *Duro Felguera, SA.*”
- As held in *Vidya Drolia*⁸, the Supreme Court concurred that (i) the court may rarely interfere at the Section 11 stage unless it is *ex facie* certain that the arbitration agreement is nonexistent, invalid or the disputes are non-arbitrable; (ii) the restricted review is to protect parties from being forced to arbitrate when the matter is demonstrably ‘non-arbitrable’ and to cut off the deadwood; and (iii) *prima facie* examination is not full review but a primary first review to weed out manifestly non-existent arbitration agreements and non-arbitrable disputes. When the issue of non-arbitrability is arguable and summary proceedings are insufficient, then, by default, the court shall refer the matter to arbitration.

Evaluating through the Eye of the Needle

The Supreme Court held that limited scrutiny, through the ‘Eye of Needle’, is necessary. The Supreme Court recognized a two-fold inquiry for courts in applications arising under Section 11(6) of the Arbitration Act i.e.,

- Primary inquiry into the existence and the validity of an arbitration agreement, which includes within its ambit - the applicant's privity to the said agreement.
- Secondary inquiry into the issue of non-arbitrability of the dispute. As a general principle the Arbitral Tribunal is the preferred authority to determine non-arbitrability. However, an exception to the rule is that the referral court may reject claims that are “manifestly and *ex-facie* non-arbitrable”. Founded on the principle in *Vidya Drolia* - the standard of scrutiny to identify non-arbitrability is merely *prima facie* first review of the facts provided the facts speak for themselves. Even if there is the slightest array of doubt, the disputes must be referred to arbitration.

Upon undertaking a *prima facie* review of the “basic facts”, the Supreme Court *inter alia* concluded that - (i) the implementation of the Settlement Agreement leading to the release of bank guarantees was not disputed.; (ii) after reaping the benefits of the Settlement Agreement, the Delhi HC was approached under Section 11; and ; (iii) there were no pending claims between the parties for submission to arbitration.

The *bona fides* of the allegations of coercion had a bearing on the arbitrability of the disputes. Upon inquiry, the Supreme Court found that the allegations were not bona fide. Moreover, there were no allegations of coercion compelling SPML to withdraw any pending claims under the contract as a condition for the return of the bank guarantees. Repudiation of the Settlement Agreement was therefore an afterthought to wriggle out of the Settlement Agreement. While concluding that the plea of coercion lacked *bona fide* and was *ex facie untenable*, the Supreme Court set aside the Delhi HC’s Order.

Analysis

How far can the scope of inquiry be stretched?

It is now well settled that the inquiry by a court under Section 11 (6) is circumscribed i.e., non-arbitrability shall be deduced by - “*prima facie*” factual review, “*primary review*” of facts, or “*ex facie*”. The dilemmas that often arise are – objectively, to what extent can a court delve into its inquiry? and/or how does one assign evidentiary value to documents in an application under Section 11(6), especially when allegations of coercion are made?

Citing the present case as an illustration of where court intervention becomes necessary, the Supreme Court held that the High Court should have struck down the *ex facie* baseless and dishonest litigation by employing its restricted review. While an over-stretched inquiry could result in a decision on arbitrability that ought to have been decided by the tribunal, through this decision, the Supreme Court has reflected some light on circumstances that warrant court interference.

⁴ *Union of India & Ors. v. Master Construction Company*, (2011) 12 SCC 349.

⁵ *New India Assurance v. Genus Power Infrastructure Ltd.*, (2015) 2 SCC 424.

⁶ *Duro Felguera S.A v. Gangavaram Port Ltd.*, (2017) 9 SCC 729.

⁷ *Mayavati Trading (P.) Ltd. v. Pradyut Deb Burman*, (2019) 8 SCC 714.

⁸ *Vidya Drolia & Ors. v. Durga Trading Corporation*, (2021) 2 SCC 1

As observed in this judgment, after *Vidya Drolia*, the apex court has taken a considered view that the arbitral tribunal is the first authority to determine questions of arbitrability – when a prima facie review on the objection of non-arbitrability was found to be inconclusive by the Court under Section 11⁹. Having said that, the *Vidya Drolia* case dealt with a broader issue concerning the arbitrability of disputes governed by the Transfer of Property Act, 1882. Whereas, in the present case, the court undertook an assessment of facts, albeit briefly, to ascertain arbitrability. Moving forward, the high courts must exercise caution to avoid delving into intricate questions of facts and to remain within their jurisdiction under Section 11.

Striking a balance between upholding the arbitration agreement and fulfilling the duty of the court

As recognized in this judgment, there is an intertwined duty of the referral court to (i) safeguard parties from being compelled to arbitrate when the matter is clearly non-arbitrable; and (ii) deny reference in the interest of avoiding wastage of resources. Considering an absolute “hands off” approach by the court would be counterproductive¹⁰, a fine balance must be achieved in upholding the arbitration agreement and fulfilling the duty of the court. Additionally, it is worth considering that parties have a route to safeguard themselves from protracted arbitration proceedings i.e., parties can apply to the constituted arbitral tribunal to make an early determination on the issue of arbitrability. Having said that, the decision on whether the issue of non-arbitrability can be addressed as a preliminary matter by the tribunal depends on various factors, including the applicable rules of procedure.

We hope you have found this information useful. For any queries/clarifications please write to us at insights@elp-in.com or write to our authors:

Ria Dalwani, Principal Associate – Email – riadalwani@elp-in.com

Sharmin Kapadia, Associate – Email - sharminkapadia@elp-in.com

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

⁹ *Pravin Electricals Pvt. Ltd. v. Galaxy Infra & Engg. Pvt. Ltd.*, (2021) 5 SCC 671 ; *Sanjiv Prakash v. Seema Kukreja*, (2021) 9 SCC 732; *IOCL v. NCC Ltd.*, (2023) 2 SCC 539.

¹⁰ *Vidya Drolia & Ors. v. Durga Trading Corporation*, (2021) 2 SCC 1