

Dispute Resolution Hotline

May 15, 2019

ARBITRATION CLAUSE IN AN UNSTAMPED AGREEMENT? SUPREME COURT LAYS DOWN THE LAW

- Unless the agreement which prescribes the arbitration clause is sufficiently stamped, the court cannot appoint an arbitrator;
- The court must impound the agreement on which adequate stamp duty has not been paid and hand it over to the relevant stamp authority for rectification;
- The stamp authorities should resolve the issues relating to stamp duty and penalty (if any) as expeditiously as possible, and preferably within a period of 45 days from the date on which the authority receives the agreement.

INTRODUCTION

The Supreme Court of India in a recent judgment has considered the validity of an arbitration clause and the arbitral appointment made thereunder, when such arbitration clause formed part of an unstamped agreement. More specifically, in case of *Garware Wall Ropes v. Coastal Marine Constructions & Engineering Ltd.*,¹ the Supreme Court had to consider an appeal arising out of the decision of the Bombay High Court, wherein an arbitrator was appointed pursuant to an arbitration clause arising out of an unstamped agreement. The Supreme Court set aside the Bombay High Court decision and remitted the same for a fresh determination.

FACTS

Disputes arose out of a sub-contract between the Appellant and the Respondent ("**Contract**"), following which the Appellant terminated the Contract. The Contract contained an arbitration clause for the resolution of the disputes. The Respondent invoked the arbitration clause and appointed an arbitrator. However, the Appellant disputed such appointment. Thereafter, the Respondent filed an application under Section 11 of the Arbitration and the Conciliation Act, 1996 ("**Act**") before the Bombay High Court seeking the appointment of an arbitrator. The Bombay High Court allowed the application and appointed an arbitrator to adjudicate the disputes between the parties.

ISSUE BEFORE THE SUPREME COURT

The Supreme Court had to consider the effect of an arbitration clause contained in an agreement which is not stamped.

JUDGMENT OF THE SUPREME COURT

Existence v. Validity of the Arbitration Agreement

The Supreme Court referred to its earlier decision in *SMS Tea Estates v. Chandmari Tea Co. P. Ltd.*,² wherein it had held that if an arbitration clause is contained in an unstamped agreement, the Judge would be required to impound the agreement and ensure that stamp duty and penalty (if any) are paid before proceeding with the appointment of the arbitrator.

Subsequent to this judgment, in 2015, Section 11(6A) was introduced to the Act, which states that while appointing an arbitrator, courts should confine themselves to the examination of the *existence* of an arbitration agreement and no more. Relying on the introduction of Section 11(6A), it was contended that the judge appointing an arbitrator should not impound the agreement for being insufficiently stamped, rather the arbitrator appointed pursuant to Section 11 may do so if deemed necessary.

The Supreme Court observed that under the Maharashtra Stamp Act, 1958 ("**Stamp Act**"), an agreement becomes enforceable in law only when it is duly stamped. The Respondent attempted to draw a distinction between the "validity" and the "existence" of an arbitration agreement, and argued that the provisions of the Stamp Act are fiscal measures which will be covered under a determination of the "validity" of an arbitration clause and not its "existence", and thereby, the court should be permitted to appoint arbitrators even in cases where the agreement is unstamped. However, the Supreme Court was not impressed with such submissions and observed that an arbitration clause cannot be bifurcated entirely from the agreement it is contained in, as the Stamp Act applies to the entire agreement. Consequently, an arbitration clause would not '*exist*' when the underlying agreement is not enforceable under law. Accordingly, the Supreme Court held that under Section 11 of the Act, the court can impound an agreement if it is not stamped in accordance with the mandatory provisions of the Stamp Act.

Interestingly, a full-judge bench of the Bombay High Court had rendered a judgment just a few days prior to the Supreme Court's finding in the present case on a similar question of law. In the case of *Gautam Landscapes Pvt. Ltd. v. Shailesh Shah*,³ the Bombay High Court held that for appointment of arbitrators under Section 11 of the Act, it was not necessary for courts to await the adjudication of stamp duty by stamp authorities in cases where a document was not adequately stamped. After considering this judgment, the Supreme Court held that the Bombay High Court in the aforementioned case had incorrectly decided the question of law.

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The Respondent further argued that impounding an unstamped agreement would not be practically feasible at the Section 11 stage as the amended Act prescribes strict timelines to courts for disposing applications for appointment of arbitrator(s). Under Section 11(13) of the Act, an application for appointment of an arbitrator must be disposed of as expeditiously as possible, and in any event within a period of 60 days from the date of service of notice on the other party.

However, the Supreme Court held that the doctrine of harmonious construction should be adopted to read Section 11(13) of the Act with Sections 33 and 34 of the Stamp Act (which provide for impounding of unstamped instruments). The Supreme Court took a step further to lay down a mechanism to be followed by courts and stamp authorities when the underlying agreement is unstamped:

- a. The High Court must first impound the agreement which does not bear the requisite stamp duty;
- b. The unstamped or insufficiently stamped agreement should be handed over to the relevant authority under the Stamp Act, which will decide the issues relating to stamp duty and penalty (if any) as expeditiously as possible, and preferably within a period of 45 days from the date on which the authority receives the agreement;
- c. Once the requisite stamp duty and penalty (if any) is paid by the parties, the parties can bring the instrument to the notice of the High Court. The High Court will then proceed to expeditiously hear and dispose of the Section 11 application.

ANALYSIS

Although the Supreme Court has balanced the dual objectives of expeditious disposal of cases and revenue collection by the authorities, it is unclear if such measures are sustainable. It remains to be seen how the judgment is practically implemented. In practice, the procedure to impound an agreement and payment of stamp duty is likely to take much longer than 45 days. Prescribing a 45-day timeline is ambitious, to say the least, but nevertheless, it remains to be seen whether the parties and the courts can meet this timeline.

One must also be cognizant of the fact that the present decision of the Supreme Court may not have any precedential value. The Supreme Court in *State of West Bengal v. Associated Contractor*,⁴ had held that the decision of the Chief Justice or his designate in a Section 11 application, not being the decision of the Supreme Court or the High Court, has no precedential value, being a decision of a judicial authority, which is not a court of record. Therefore, there may be a confusion on the how courts approached under the other sections of the Act would deal with arbitration clauses contained in unstamped agreements.

— Bhavana Sunder & Alipak Banerjee

You can direct your queries or comments to the authors

¹ Civil Appeal No. 3631 of 2019 arising out of SLP(C) No. 9213 of 2018.

² (2011) 14 SCC 66

³ Arb. Pet. No. 466 of 2017 (decided on 04.04.2019).

⁴ Civil Appeal No. 6691 Of 2005; Civil Appeal No. 4808 Of 2013.

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