

Indian Supreme Court strikes down pre-deposit requirement in arbitration agreement (M/S Icomm Tele v Punjab State Water Supply & Sewerage Board)

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Arbitration analysis: The Indian Supreme Court (the Court) held as arbitrary and unconstitutional, an arbitration clause mandating a contractor of a State's Water Supply and Sewerage Board (the State Board) to furnish a pre-deposit of 10% of the amount of its claim in arbitration at the time of invocation of arbitration. In doing so, the Court re-affirmed the primary purpose of arbitration as 'de-clogging the Court system.' The Court held that such a pre-deposit clause was itself a 'clog' on entering the arbitral process and would render the same impermissibly 'ineffective and expensive.' Siddharth Ratho, Senior Member and Moazzam Khan, head of the International Dispute Resolution Practice at Nishith Desai Associates consider the decision.

M/S Icomm Tele Ltd v Punjab State Water Supply & Sewerage Board & Anr Civil Appeal No 2713 of 2019 (arising out of SLP (Civil) No 3307 of 2018)

What are the key implications of this decision?

In the recent past, we have witnessed courts increasingly adopting a pro-arbitration approach by refraining from interfering in the arbitral process. This judgment however, is a unique example of a court forwarding the object of arbitration by in fact taking the bold step of 'interfering' and rectifying a commercial understanding between parties that was found to be arbitrary and discouraging towards the arbitration process.

Through this judgment, the judiciary has demonstrated the ideal way in which courts may play a guiding role in the arbitral process by stepping in constructively when parties may overstep the four corners of the constitution or may act against the very objective of arbitration, while maintaining utmost reverence for party autonomy, the very crux of alternative dispute resolution mechanism. Parties should be mindful that although commercial contracts may be protected from judicial scrutiny, they are still required to be fair, just and reasonable.

It will also be interesting to see if this judgment leads to development of a new jurisprudence around claiming exemplary costs and damages and the calculation thereof in cases of frivolous claims.

What was the background?

The State Board had issued a notice inviting tender for certain works related to augmentation of water supply, sewerage schemes, pumping stations and such. M/S Icomm Tele Ltd (the Contractor) was eventually awarded the tender. Accordingly, a formal contract was entered between the State Board and the Contractor with the notice inviting the tender forming part and parcel of the formal contract.

The arbitration clause in question read as follows:

'viii. It shall be an essential term of this contract that in order to avoid frivolous claims the party invoking arbitration shall specify the dispute based on facts and calculations stating the amount claimed under each claim and shall **furnish a "deposit-at-call" for ten percent of the amount claimed**, on a schedule bank in the name of the Arbitrator by his official designation who shall keep the amount in deposit till the announcement of the award. In the event of an award in favour of the claimant, the deposit shall be refunded to him in proportion to the amount awarded w.r.t the amount claimed and the balance, if any, shall be forfeited and paid to the other party.'

When disputes arose and arbitration was subsequently invoked, the Contractor sought waiver of the pre-deposit of 10% of the claim amount. On such a request being denied, the Contractor approached the High Court of Punjab & Haryana challenging the validity of such a pre-deposit requirement. However, the High Court did not find the condition to be arbitrary or unreasonable, thereby refusing to strike it down. The Contractor accordingly approached the Supreme Court to decide whether such a clause was in fact arbitrary and/or discriminatory, violative of Article 14 of the constitution of India (Article 14) and therefore liable to be set aside.

Contractor's submissions

The Contractor argued that the arbitration clause amounts to a contract of adhesion since there is unfair bargaining power between itself and the State Board due to which it ought to be struck down in keeping with the principals laid down in *Central Inland Water Transport Corpn v Brojo Nath Ganguly (1986) 3 SCC 156* (not reported by LexisNexis® UK). The Contractor further argued that such a clause was arbitrary and violative of Article 14 as even if the award is in favour of a claimant, what would be refunded is only in proportion to the actual amount awarded with the rest being forfeited to a respondent, despite it having lost the case.

Lastly it argued that the 10% deposit requirement would amount to a clog on entering the arbitration process while attempting to discourage filing of frivolous claim, and that in any event, frivolous claims could always be compensated through heavy costs stipulated in the eventual award.

State Board's submissions

The State Board countered the above stating that there is no such infraction of Article 14 since the said clause would apply to both parties equally, and this being the case, the clause cannot be struck down as being discriminatory. It further submitted that *Central Inland Water Transport Corpn* which lays down that contracts of adhesion ie contracts in which there is unequal bargaining power between private persons and the State are liable to be set aside because they are unconscionable, does not apply where both parties are businessmen and where the contract is a commercial transaction.

What did the Indian Supreme Court decide?

Violation of Article 14

The Court held that a clause can be violative of Article 14 if it is found to be discriminatory or arbitrary. It agreed with the State Board's argument that the concept of unequal bargaining does not apply to commercial contracts and that therefore the said clause could not be said to be discriminatory. The reason being that businessmen ought to be aware of the nature of commercial transactions and therefore cannot use the argument of unequal bargaining power to their advantage. However, it placed reliance on *ABL International Ltd. v Export Credit Guarantee Corpn Of India Ltd, (2004) 3 SCC 553* (not reported by LexisNexis® UK) to hold that even within the contractual sphere, the requirement of Article 14 to act fairly, justly and reasonably by persons who are 'state' authorities or instrumentalities continues.

The Court thus opined that conditions laid down in the arbitration clause are arbitrary (even if not discriminatory) for the following reasons:

- there is no nexus between frivolous claims and the condition of 10% pre-deposit since the pre-deposit amount is a pre-condition regardless of whether the claim is frivolous or genuine. Frivolous claims can be avoided by imposing exemplary costs and therefore an arbitrary condition of pre-deposit such as in the clause in question need not be resorted to
- given the fact that the said clause envisaged refund only in proportion to the amount awarded, with the balance being forfeited to the other party, even though such a party may have lost the case, the same is certainly arbitrary and violative of Article 14, even if not discriminatory

Deterring a party from invoking arbitration is contrary to the object of de-clogging the court system

The Court emphasised that arbitration is to be encouraged because of high pendency of cases and costs of litigation. It pointed out that several judgments have reiterated that the primary object of arbitration is to reach a final disposal of disputes in a speedy, effective, inexpensive and expeditious manner. A deposit of 10% of a huge claim would be far greater than any court fee that may be charged for filing a suit, it observed. Considering this, the Court opined that deterring a party to an arbitration from invoking such an alternative resolution process by such a 'deposit-at-call' clause would discourage arbitration, contrary to the object of de-clogging the Court system, and would render the arbitral process ineffective and expensive.

Having considered the above, the Court went on to strike down the said clause and allowed the appeal of the Contractor.

The views expressed are not necessarily those of the proprietor.