

STAMPING OF THE UNDERLYING CONTRACT FOR A VALID ARBITRATION CLAUSE – AN ‘EXISTENTIAL’ CRISIS

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The Law Commission of India in its 246th Report, recommended various amendments to the Arbitration & Conciliation Act, 1996 (Act) with the objective of upgrading the existing arbitration landscape in India and bringing it in line with international best practices. When the Act was eventually amended by way of the Arbitration and Conciliation (Amendment) Act, 2015 (2015 Amendment), two such amendments were that of a newly inserted Section 11(6A),¹¹ limiting the scope of court inquiry to only the ‘existence’ of an arbitration agreement while entertaining an application for appointment of an arbitrator, and insertion of Section 11(13),¹² calling on the courts for expedited disposal of such applications within sixty days.

The objective behind such amendments was to streamline the Indian arbitration regime which has historically been prone to severe delay. Arbitration applications, even for simpliciter appointment of arbitrators, languish in courts for years. However, in what may just be a case of one step forward and two steps back, the Supreme Court of India recently raked up an old issue concerning the validity of an arbitration agreement by holding that a court cannot appoint an arbitrator under Section 11 of the Act when the contract containing the arbitration clause is insufficiently stamped.

This article shall analyse the evolution of the law with respect to the same and whether such a decision could possibly undo some of the progressive steps taken by the judiciary

and legislature in the recent past in minimizing court interference.

TO STAMP OR NOT TO STAMP – A PRECEDENTIAL THROWBACK

Prior to the 2015 Amendment, this issue was first addressed by the Supreme Court in *SMS Tea Estate (SMS Tea Estate Pvt Ltd v. Chandmari Tea Company Pvt Ltd*, (2011) 14 SCC 66). The main questions before it then was whether an arbitration agreement contained in an unregistered (but compulsorily registrable) instrument is valid and enforceable; and second, whether an arbitration agreement in an unregistered instrument (whether compulsorily registrable or not) which is not duly stamped, is valid and enforceable. On the first question, the Supreme Court answered in the affirmative. It considered that an arbitration agreement is severable from the main instrument and is also saved by the proviso to Section 49 of the Registration Act of 1908 (Registration Act) which allows an unregistered document affecting immovable property to be received as evidence.¹³

Accordingly, it held that the said arbitration agreement in an unregistered, but compulsorily registrable instrument is valid. However, the Court also noted that even though such an appointment is theoretically permissible, it would be of no practical use, as even if the arbitrator is appointed, it cannot adjudicate upon the disputes emanating from the terms of the said unregistered document.

In dealing with the second question, the Supreme Court held that the arbitration agreement in an unstamped instrument is invalid, given that Section 35 of the Indian Stamp Act, 1899 (Stamp Act) explicitly prohibits the courts from acting on a document on which stamp duty has not been paid or is insufficient. Even though the arbitration agreement is severable from the main instrument, it is not saved by any provision in the Stamp Act, as in the case of Section 49 of the Registration Act. Thus, it held that in case an unstamped or insufficiently stamped instrument is presented before a court in a Section 11 application, the said instrument must first be impounded as per the Stamp Act and only after satisfaction of the stamp duty can the court appoint an arbitrator.

A STEP FORWARD - MERE ‘EXISTENCE’ OF AN ARBITRATION AGREEMENT SUFFICIENT FOR BOMBAY HIGH COURT

Subsequent to the 2015 Amendment, a full judge bench of the Bombay High Court recently had occasion to deal with this issue once again in *Gautam Landscapes (Gautam Landscapes Pvt Ltd v. Shailesh S Shah, Arb Pet. 466/2017 & Arb App 246/2016 and Vijay Sharma v. Vivek Makhija, Arb App 300/2018)*. It had to decide two principal questions. First, whether a court can grant reliefs under Section 9 of the Act, based on an arbitration agreement contained in an unstamped or insufficiently stamped document. Second, whether, considering the insertion of Section 11(6A), a court may now appoint an arbitrator regardless of sufficient stamping

¹¹ The Arbitration and Conciliation Act, 1996, §11(6A): *The Supreme Court or, as the case may be, the High Court, while considering any application under sub-section (4) or sub-section (5) or sub-section (6), shall, notwithstanding any judgment, decree or order of any Court, confine to the examination of the existence of an arbitration agreement.*

¹² The Arbitration and Conciliation Act, 1996, §11(13): *An application made under this section for appointment of an arbitrator or arbitrators shall be disposed of by the Supreme Court or the High Court or the person or institution designated by such Court, as the case may be, as expeditiously as possible and an endeavour shall be made to dispose of the matter within a period of sixty days from the date of service of notice on the opposite party.*

¹³ The Registration Act, 1908, §49, Proviso: *Provided that an unregistered document affecting immovable property and required by this Act or the Transfer of Property Act, 1882 (4 of 1882), to be registered may be received as evidence of a contract in a suit for specific performance under Chapter II of the Specific Relief Act, 1877 (3 of 1877), or as evidence of any collateral transaction not required to be effected by registered instrument.*

of the underlying contract containing the arbitration agreement.

The Bombay High Court answered the first question in the affirmative, noting that since *SMS Tea Estate* rendered its findings only with respect to Section 11 applications, it has no precedential value with respect to applications under Section 9. Instead, it considered the decision of the Supreme Court in *Firm Ashok Traders (Firm Ashok Traders v. Gurumukh Das Saluja, (2004) 3 SCC 155)*, wherein it was held that the scope of inquiry by a court in a Section 9 application is restricted only to the existence of an arbitration agreement since the right under a Section 9 application does not arise from the contract, but from the arbitration agreement itself. It reaffirmed the deeply enshrined doctrine of severability on a joint reading of Sections 7(2)¹⁴ and 16(1)(a)¹⁵ of the Act.

Furthermore, it distinguished a Section 9 from a Section 11, on the basis that a Section 9 application is for interim/ad interim reliefs to protect the eventual award, which if delayed can cause irrevocable injury to a party. Moreover, it found that the Stamp Act is only a fiscal statute that cannot be used to arm recalcitrant respondents with technical objections. In any case, it held, that if at all, the issue of insufficient stamp duty can always be dealt with by the arbitral tribunal at the appropriate juncture.

In considering the second question, the Bombay High Court placed reliance upon the Supreme Court judgement in *Duro Felguera v. Gangavaram Port Ltd, (2017) 8 SCC 729*, wherein it was held that post the 2015 Amendment, courts could only look into the 'existence' of arbitral agreements, and that therefore, the issue of insufficiency of stamp duty on the underlying contract is outside the scope of inquiry of the court. It found that this was in line with the object behind insertion of Section 11(6A) which is to minimise judicial interference at the stage of appointment of the arbitrator. The Bombay High Court thus chose to further the legislative intent behind the 2015 Amendment, minimize court interference and expedite the disposal of section 11

applications for speedy initiation of arbitral proceedings.

SUPREME COURT ROLLS IT BACK TO SQUARE ONE

Whatever progress that may have been achieved by the Bombay High Court decision in *Gautam Landscapes* was undone within a week by the Supreme Court in its judgement dated April 10, 2019 in *Garware Wall Ropes (Garware Wall Ropes Ltd v. Coastal Marine Constructions & Engineering Ltd, Appeal (Civil) 3631/2019)*. The issue reached the Supreme Court in an appeal from an order of the Bombay High Court in a Section 11 application. The Supreme Court in deciding the appeal, reverted to the position taken in *SMS Tea Estate*, holding that the final order in an application under Section 11 can only be made on satisfaction of stamp duty under relevant provisions of the Stamp Act.

On a reading of the 246th Law Commission Report along with its statement of objects and reasons, it found that the language "notwithstanding any judgment, decree or order of any Court" in Section 11(6A) was specifically inserted to undo the effect of its decision in *Patel Engineering (SBP & Co v. Patel Engineering Ltd, (2005) 8 SCC 618)* and *Boghara Polyfab (National Insurance Co Ltd v. Boghara Polyfab (P) Ltd, (2001) 1 SCC 267)* which had left the door wide open for courts to deal with preliminary issues unrelated to the existence of the arbitration agreement. However, nowhere did it find any mention of doing away with the effect of *SMS Tea Estates*, either in the Statement of Objects and Reasons or the 346th Report itself. Therefore, it held that *SMS Tea Estates* was still good law. It further observed that the Stamp Act requires the document to be impounded as a whole, thereby ruling out the possibility of bifurcating the arbitration agreement from the rest of the document, and thus rejecting the doctrine of severability as espoused in *Gautam Landscapes*.

From a joint reading of Section 7(2) of the Act, Section 2(h)¹⁶ of the Indian Contract Act, 1872 (Contract Act) and its judgment in *United India Insurance (United India Insurance Co Ltd v. Hyundai Engineering and Construction Co Ltd, (2018) SCC Online SC 1045)*, it held that 'existence' of an arbitration

agreement in fact is different from its 'existence' in law, and that it is the latter that is to be examined. Observing that Section 7(2) of the Act describes two kinds of arbitration agreements, first, as a clause in a "contract" and second, as a separate agreement, it opined that the arbitration agreement in the former situation will only be valid if the agreement containing the clause is enforceable by law. Reading this with the *United India Insurance* principle, it held that an arbitration agreement cannot exist in an unenforceable agreement and that therefore it cannot be said to exist in a document which is insufficiently stamped.

SO, WHAT DOES THIS MEAN FOR APPLICATIONS UNDER SECTION 9?

What the Supreme Court did not do was tackle the issue of insufficient stamping of a contract containing an arbitration clause in an application under Section 9, leaving the question on the validity of orders passed therein open to further judicial scrutiny.

Having said that, the scope of powers under Section 9, as defined in *Firm Ashok Traders*, limited court inquiry only to the existence of an arbitration agreement. However, the rejection of the doctrine of severability with respect to the Stamp Act and the principle of 'existence in law' as espoused in *United India Insurance* could theoretically also be extended to Section 9 applications, albeit not dealt with by the Supreme Court yet. At the same time, the idea of irrevocable injury caused due to a delay in Section 9 application also holds merit. Unless the Supreme Court settles this question with respect to Section 9 as well, it is safe to assume that this 'existential crisis' shall continue for a while.

CONCLUSION

The judiciary has generally adopted a pro-arbitration approach since the turn of the decade, beginning with the infamous *BALCO* judgement. *Gautam Landscapes* was yet another step towards establishing an arbitration regime in line with international best practices and minimizing unwarranted court interference. The *Garware Wall Ropes* judgment of the Supreme Court now comes against the run of play, rolling back some of

¹⁴ The Arbitration and Conciliation Act, 1996, §7(2): *An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.*

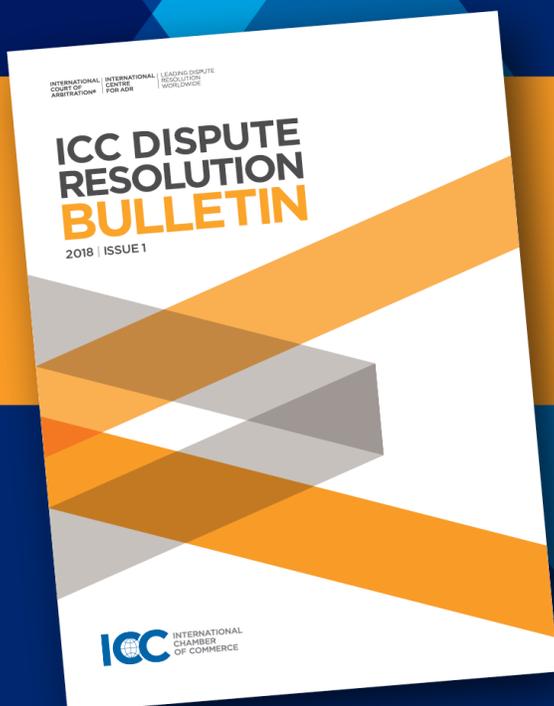
¹⁵ The Arbitration and Conciliation Act, 1996, §16(1)(a): *[a]n arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract.*

¹⁶ The Indian Contract Act, 1872, §2(h): *An agreement enforceable by law is a contract.*

the progress made towards a more streamlined arbitration regime free of technical hassles.

The importance of dues owed to the exchequer is understandable and cannot be denied. However, the Supreme Court may have missed out on a chance to refrain from interfering and allowing the alternate dispute resolution mechanism to deal with issues including insufficient stamping of documents. This would have created a perfect balance wherein arbitration is proceeded with without delay while at the same time revenues due to the exchequer is also ensured. While revenue due to the exchequer is certainly vital, so is the perception of the country in terms of ease of doing business and contract enforcement, a cause which the Supreme Court may just have missed out on advancing.

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