

# Dispute Resolution Hotline

March 16, 2021

## TIME TO RE-THINK SCOPE OF APPEAL IN ARBITRAL APPOINTMENTS

- Parliament may need to have a re-look at Section 11 (7) and Section 37 of the Act;
- Arbitrator directed to determine existence of an arbitration agreement as a preliminary issue prior to considering merits.

### INTRODUCTION

Recently, the Supreme Court in *Pravin Electricals Pvt. Ltd. v. Galaxy Infra and Engineering Pvt. Ltd.* (“**Pravin Electricals**”),<sup>1</sup> noted that Parliament may need to have a re-look at Section 11(7) and Section 37 of the Arbitration and Conciliation Act, 1996 (“**Act**”) so that orders made under Section 8 and 11 are brought at par with respect to their appealability.

Before we delve into the facts and analysis in the present ruling, we have discussed the scope of provisions relating to ‘reference to arbitration’ and ‘appointment of arbitrators’ and the ‘scope of appealable orders’ under the Act.

#### ■ Reference to arbitration under Section 8:

Under the act, a judicial authority is obligated to refer an ongoing dispute to arbitration if disputes arise out of a contractual relationship which includes an arbitration agreement. However, the judicial authority shall not refer the parties to arbitration if it finds that *prima facie* no valid arbitration agreement exists.<sup>2</sup> The Supreme Court, in *Vidya Drolia v. Durga Trading Corporation* (“**Vidya Drolia**”), dealt with the scope of a *prima facie* determination of an arbitration agreement.<sup>3</sup>

In *Vidya Drolia*, the Supreme Court stated that the courts need not venture into debatable questions of facts surrounding the dispute. Nevertheless, courts must consider the following instances to refuse reference to arbitration in an application under Section 8 – (a) when the cause of action relates to an action in *rem*, (b) when the subject matter of the dispute affects third-party rights, have *erga omnes* effect and requires centralised adjudication; (d) when the subject matter of the dispute relates to inalienable sovereign and public interest functions of the state; (e) when the subject matter of the dispute is expressly non-arbitrable as per Indian statutes.

#### ■ Arbitrator Appointment under Section 11:

If parties to an arbitration agreement fail to appoint an arbitrator, the court can appoint the arbitrator for the parties.<sup>4</sup> The Arbitration and Conciliation (Amendment) Act, 2015 (“**2015 Amendment Act**”) inserted a new provision limiting the scope of judicial review in a petition under Section 11. The 2015 Amendment Act confined the courts to only examine the ‘*existence*’ of an arbitration agreement in an application under Section 11.<sup>5</sup>

The Supreme Court in *Vidya Drolia* deliberated on the scope of ‘*existence*’ of the arbitration agreement while deciding an application under Section 11. The Supreme Court held that the ‘*existence*’ and ‘*validity*’ of an arbitration agreement are intertwined. Further, an arbitration agreement does not exist if it is illegal or does not satisfy mandatory legal requirements.<sup>6</sup>

#### ■ Appealable order under the Act: Section 8 vis-à-vis Section 11

Section 37 of the Act exhaustively enlists orders against which an appeal can be preferred by parties under the Act. A party can prefer an appeal under Section 37, *inter alia*, against an order of the court refusing to refer the parties to arbitration under Section 8. However, parties cannot prefer an appeal under Section 37 against an order of the court under Section 11.

### FACTUAL BACKGROUND

The appeal before the Supreme Court arose from a Delhi High Court (“**High Court**”) order on appointment of an Arbitrator under Section 11(6) of the Act to adjudicate disputes between the parties regarding payment obligations. The High Court, relying on the documentation placed on record, concluded that an arbitration agreement existed and referred the parties to arbitration for adjudication of the dispute. The High Court appointed a Sole Arbitrator. On appeal, the Supreme Court was faced with the issue on whether an arbitration agreement, in fact, existed.

### SUPREME COURT RULING AND ANALYSIS:

The Supreme Court inferred that it cannot render a conclusive finding to the effect that there exists an arbitration agreement between the parties as, amongst other reasons:

1. The agreement dated July 07, 2014 was ostensibly executed before a notary in Faridabad, Haryana whereas the parties had their registered offices in Bihar and Mumbai respectively. Further, on the date on which the

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agreement was executed, the license of the notary had expired.

2. Report of Central Forensic Science Laboratory (CFSL) regarding the specimen signatures of the Appellant's managing director was inconclusive.
3. The parties were in discussions even on July 15, 2014 i.e. subsequent to the alleged contract coming into force, where the Appellant disputed various terms of the draft contract in reply to the email dated July 15, 2014; this suggested that no concluded contract between the parties was in fact existing.
4. Before the High Court, the Respondent contended that the contract was concluded on a different date - on July 07, 2014, as opposed to July 15, 2014.

The Supreme Court noted that the issue of existence of an arbitration agreement would involve the examination of documentary evidence and witness testimony. Since the proceedings under Section 11 of the Act are summary in nature, questions on the existence of an arbitration agreement cannot be examined solely from a factual perspective.

The Supreme Court set aside the order of the High Court to the extent it found the existence of an arbitration agreement between the parties. However, the Supreme Court upheld the appointment of the arbitrator by the High Court. The Supreme Court left the question of existence of the arbitration agreement to be determined by the arbitrator as a preliminary issue. Further, it directed that the arbitrator would go ahead with the merits of the case only if it was found that an arbitration agreement exists between the parties.

Such a direction is in consonance with the Indian judiciary's pro-arbitration approach. At the same time, it also ensures that where the existence of an agreement is dealt with as a preliminary issue, the parties are not subjected to the rigor of the entire arbitration proceedings, until and unless there is a clear finding on the existence of an arbitration agreement.

Separately, the Supreme Court noted that as a result of the judgment in *Vidya Drolia*, Section 8(1) and Section 11(6) of the Act have been brought at *par* with regards to the scope of determination of the validity / existence of the arbitration agreement. The Supreme Court inferred that an anomaly has arisen as a result of the parity between the scope of Section 8 and 11 coupled with existing incongruity in their appealability under the Act.

An application under Section 8 of the Act is subject to a *prima facie* determination of the validity of the arbitration agreement. A *prima facie* determination of the validity of the arbitration agreement would entail a consideration of the factors laid down in *Vidya Drolia*. In light of the above, the Supreme Court noted that parliament may need to re-look at the relevant provisions so that orders made under Sections 8 and 11 are brought on *par qua* appealability.

— Adimesh Lochan, Payel Chatterjee & Sahil Kanuga

You can direct your queries or comments to the authors

<sup>1</sup> Civil Appeal No. 825 of 2021.

<sup>2</sup> Section 8, Power to refer parties to arbitration where there is an arbitration agreement - Arbitration and Conciliation Act, 1996

(1) *A judicial authority, before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party to the arbitration agreement or any person claiming through or under him so applies not later than the date of submitting his first statement on the substance of the dispute, then, notwithstanding any judgment, decree or order of the Supreme Court or any Court, refer the parties to arbitration unless it finds that prima facie no valid arbitration agreement exists.*

<sup>3</sup> *Vidya Drolia v. Durga Trading Corporation* (2021) 2 SCC 1.

<sup>4</sup> Section 11 (4), Appointment of arbitrators - Arbitration and Conciliation Act, 1996.

<sup>5</sup> Section 11 (6A), Arbitration and Conciliation Act, 1996

*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.*

<sup>6</sup> ¶ 92, *Vidya Drolia v. Durga Trading Corporation* (2021) 2 SCC 1.

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