

Kluwer Arbitration Blog

Does Separability Salvage an Arbitration Agreement Contained in an Unstamped Document under Indian Law?

Karan Rukhana (Chambers of Darius Khambata, SC) · Wednesday, April 7th, 2021

Section 35 of the [Indian Stamp Act, 1899](#), which is similar to Section 14(4) of the English Stamp Act, 1891, provides that, any instrument executed within the country that is unstamped or inadequately stamped, cannot be read in evidence “for any purpose”, barring in criminal proceedings. The provision is widely worded, but, does it preclude enforcement of an arbitration agreement contained in an unstamped document? For arbitration practitioners, the answer appears simple enough: the doctrine of separability allows for enforcement of such an arbitration agreement.

The question arose before the Indian Supreme Court (“**Court**”) in *M/s. N. N. Global Mercantile Pvt. Ltd. v. M/s. Indo Unique Flame Ltd. & Ors.* as to the enforceability of an arbitration clause contained in an unstamped Work Order. The Court observed that such an arbitration agreement was indeed enforceable and doubted the correctness of two prior decisions which had held otherwise; one of which was recently confirmed by a bench of equal strength of the Court¹ (i.e. comprising 3 judges sitting together).

Notwithstanding its desire to give effect to the arbitration agreement, the Court was constrained by the doctrine of *stare decisis* (i.e. a constitutional requirement to follow precedent decisions issued by an equivalent court, when comprising an equal number of judges) and had to refer the question to a larger bench for determination.

Facts in *Global Mercantile*

Indo Unique and Global Mercantile entered into a contract, a Transport Work Order, for transportation of coal. The Transport Work Order provided for Global Mercantile to furnish a security deposit in the form of a bank guarantee in Indo Unique’s favour, which it did, and for settlement of any disputes through arbitration.

Disputes arose between the parties. Indo Unique invoked the bank guarantee. Global Mercantile challenged this invocation by way of a suit which Indo Unique resisted and sought a reference to arbitration under Section 8 of the Indian Arbitration and Conciliation Act, 1996 (Indian Arbitration Act). Global Mercantile opposed the reference, amongst others, on the ground that the Transport Work Order that contained the arbitration agreement was not stamped as per the Maharashtra

Stamp Act, 1958. It argued that the arbitration agreement did not exist in law.

The Decision

The Court decided that “[t]he arbitration agreement would not be rendered invalid, un-enforceable or non-existent, even if the substantive contract is not admissible in evidence or cannot be acted upon on account of non-payment of Stamp Duty” for the following four reasons.

First, and the most fundamental, the doctrine of separability. After ferreting a warren of classic cases on separability and examining Section 16 of the Indian Arbitration Act (which is based on Article 16 of the UNCITRAL Model Law of International Commercial Arbitration) the Court found ample support to state that the arbitration agreement is a separate agreement and therefore, would survive independent of the substantive contract. This reasoning also forms the fiber underlying the remaining three reasons.

Second, the legislative policy of minimal interference by courts whilst referring matters to arbitration following the recent amendments to the Indian Arbitration Act. On a combined reading of Sections 5 and 16 of the Indian Arbitration Act and the insertion of Section 11 (6A) (which amendment only requires courts to determine the existence (and not validity) of an arbitration agreement—and not of the underlying contract—before referring parties to arbitration), the Court held that the question as to whether the substantive contract was voidable for non-payment of stamp duty could be resolved by the arbitrator deferring to kompetenz-kompetenz. Since the Court was satisfied of the existence of the arbitration agreement, it ought to refer parties to arbitration despite any such apparent defect.

Third, *SMS Tea Estates v. M/s Chanmari Tea Co.* (SMS Tea Estates) and *Garware Wall Ropes v. Coastal Marine Constructions and Engineering Ltd.* (Garware Wall Roes), two prior decisions of the Supreme Court, did not reflect the correct legal position on this issue. It overruled *SMS Tea Estates* for two reasons: (i) it predated the insertion of Section 11(6A) that further curtailed court interference and (ii) it wrongly did not extend separability to salvage the arbitration agreement from an unregistered contract. As for *Garware Wall Ropes*, which was inspired by *SMS Tea Estates* and did not give due respect to separability by holding that the arbitration agreement did not exist in law till stamp duty on the substantive contract was paid. According to the Court, this judgment failed to appreciate that the two agreements were separate.

Fourth, since the Maharashtra Stamp Act (a state legislation equivalent to the Indian Stamp Act) did not specifically subject an arbitration agreement to payment of stamp duty, it did not impede enforcement of the independent arbitration agreement.

Comparing application of separability and comments

In *SMS Tea Estates* the Court acknowledged separability. It considered the separate natures of the substantive provisions in the contract and the arbitration clause, and rightly observed that the arbitration agreement is “independent of the other terms of the contract or the instrument”. But, in the same breath, the court opined that the arbitration clause “is a part of the instrument [i.e. the main contract].” In its opinion, since a court could not act upon an unstamped document, it was

precluded from enforcing the arbitration clause contained in it as well.

In *Garware Wall Ropes*, the Court was faced with a case similar to that in *SMS Tea Estates*. The respondent argued that provisions of the Stamp Act did not affect the “existence” of the arbitration agreement which was independent of the substantive contract. Unconvinced, in *Garware Wall Ropes* the Court first held that *SMS Tea Estates* survived insertion of Section 11(6A). It then followed *SMS Tea Estates* to reiterate that the Stamp Act provisions apply to a deed or document as a whole—including the arbitration clause it contains. And, therefore, rejecting separability, it concluded that “it is not possible to bifurcate the arbitration clause contained in [an] agreement or conveyance so as to give it an independent existence”. The Court also found support in a coalesced reading of Section 7(2) of the Indian Arbitration Act and Section 2(h) of the Indian Contract Act, 1872 (Contract Act). Section 7(2), like Article 7(1) of the UNCITRAL Model Law, provides that an arbitration agreement may be in the form of an arbitration clause in a “contract”, which is defined by Section 2(h) to mean “an agreement enforceable by law”. Since, as per the Stamp Act, an unstamped document is unenforceable by law, it is not a “contract”. It therefore follows that an arbitration agreement in such an unstamped document—which is not a “contract”—would not exist.

Antithetical to *SMS Tea Estates* and *Garware Wall Ropes*, the Court in *Global Mercantile* extended separability to the Maharashtra Stamp Act. In the course of overruling *SMS Tea Estates*, the Court observed that “separability of the arbitration clause on the registration of the substantive contract, ought to have been followed even with respect to the Stamp Act”. Broadly, the Court’s observations are consistent with English Law which treats an arbitration agreement as collateral to the main contract and enforces it, despite the underlying agreement being inadequately stamped.²⁾

That said, the Court failed to address the second aspect built on a collective reading of Section 7(2) of the Arbitration Act and Section 2(h) of the Contract Act as considered in *Garware Wall Ropes*. Although the argument seems attractive, it does not stand scrutiny for two reasons. *First*, by importing the definition of “contract” as stated under Section 2(h) of the Contract Act to Section 7(2) of the Arbitration Act would amount to broadening court interference at the stage of reference to arbitration. An obvious consequence of such import would mean that a court must now determine whether the underlying document is a “contract”, that is, whether it is legally enforceable. This result would dilute, if not defeat, Section 11(6A) of the Arbitration Act and the legislative intent behind it, which is to limit court’s interference to only determine existence of—only—the arbitration agreement at the time of reference. *Second*, it is important to bear in mind that Section 7(2) of the Arbitration Act is consanguineous of Article 7(1) of the UNCITRAL Model Law. “Contract” as referred to in Section 7(2) of the Arbitration Act and as defined in Section 2(h) of the Contract Act are not of the same ilk.

Conclusion

Separability shields an arbitration agreement from any defect in the underlying contract for the purpose of its validity and existence. As such, there is no reason why separability should not extend to cases of unstamped underlying contracts, especially since there is no real loss to State revenue; in most cases the parties would be compelled to pay stamp duty following adjudication in order to rely on the underlying contract to decide their substantive disputes in arbitration.

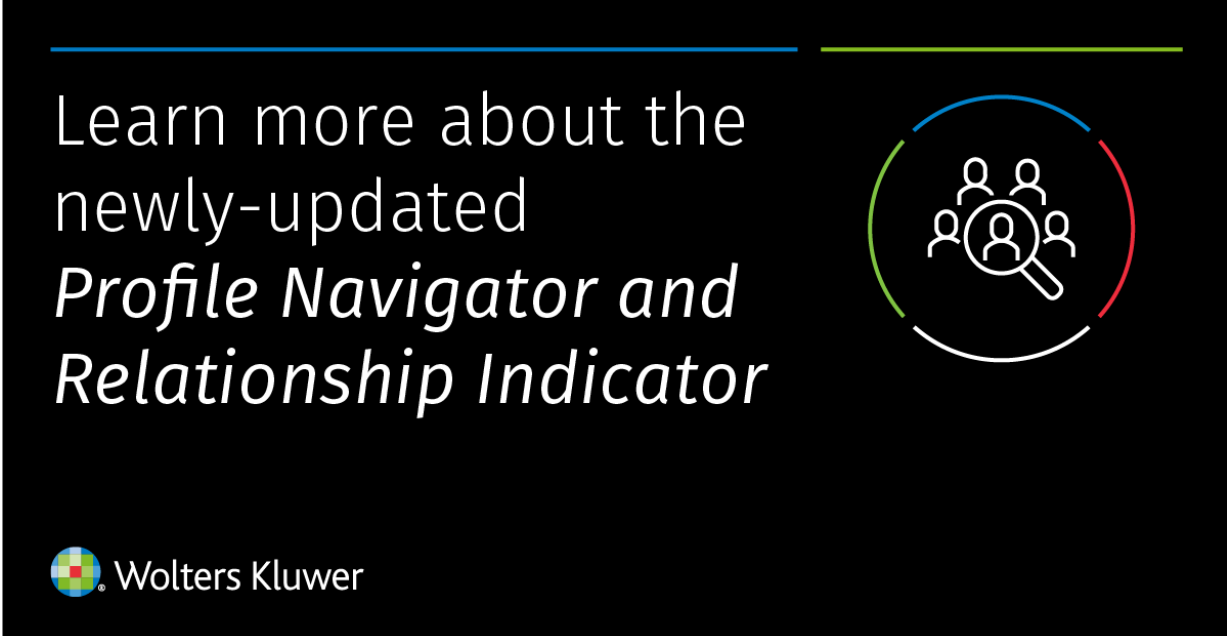
Regardless of the outcome of the five-judge Constitutional Bench reference, the *Global Mercantile* decision is to be applauded for being consistent with India's pro-arbitration stance.

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References

- ¹ *Vijay Drolia and others v. Durga Trading Corporation*, (2021) 2 SCC 1 ¶ 147 (Supreme Court of India).
- ² See *Westacre Investments v. Jugohimport-SPDR Holding*, [1998] All ER 570, 578 citing *Norske Atlas Insurance Co. Ltd. v. London General Insurance Co. Ltd.*, [1927] 28 Ll L Rep 104.

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