Kluwer Arbitration Blog

Stamp of Approval: The Indian Supreme Court Says Yes to Arbitration

Shalaka Patil and Paulomi Mehta (Trilegal) · Tuesday, February 6th, 2024

The Indian arbitration bar was waiting for an important judgment of a 7-judge bench of the Indian Supreme Court (“**Judgment**”), which reviewed its own earlier judgment in NN Global Mercantile Private Limited v. Indo Unique Flame Ltd. and Ors. (“**NN Global**”) covered in a previous blog post here. The issue before the Indian Supreme Court was whether the non-payment of stamp duty in a contract renders the arbitration agreement contained in the underlying contract unenforceable. The Indian Supreme Court in NN Global held that it did. However, the recent 7-judge bench decision issued on 13 December 2023 reversed this finding and held that unstamped or inadequately stamped agreements, while being inadmissible in evidence until stamp duty is paid, do not render the agreements void, void ab initio or unenforceable. Accordingly, the arbitration can continue while this defect is being cured.

Although the Judgment was awaited for a determination on the stamping issue, it also clarified the position of law on a number of other important issues, such as (a) the scope of arbitral interference and whether it varies when referring the arbitration under section 11 and section 8 of the Arbitration and Conciliation Act 1996 (“**Arbitration Act**”),[1)] (b) the Arbitration Act being a self-contained code, its “dependence on other legislations is either absent or minimal,” and (c) balancing party autonomy with referral to arbitration. This makes the Judgment an important exposition of law in the field of arbitration for India.

Why NN Global Was Decided As Bad Law

In the seven months since the NN Global decision was rendered, various Indian High Courts have tried to thaw the chilling effect of the judgment by exercising some interpretive acrobatics in an attempt to land one leg on arbitration while also balancing the other leg on complying with stamp duty considerations. This happened as NN Global stated that a party relying on an arbitration agreement in an underlying agreement that is inadequately stamped cannot be referred to arbitration given that the underlying agreement is void on the basis of unenforceability by law under section 2(g) of the Indian Contract Act 1872 (“**Contract Act**”). The Indian Supreme Court in NN Global came to this conclusion by reading section 35 of the Indian Stamp Act 1899 (“**Stamp Act**”), which provides that “[n]o instrument chargeable with duty shall be admitted in evidence . . . unless such instrument is duly stamped.” NN Global further held that a High Court or the Indian Supreme Court, before which a party brings an application to refer parties to arbitration under section 11 of the Arbitration Act, must look into not only the actual existence of the arbitration agreement but the existence of such an agreement in law. It then concluded that as an

inadequately stamped agreement is inadmissible under section 35 of the Stamp Act, it is void under section 2(g) of the Contract Act. Accordingly, a party cannot rely on an arbitration clause in such void agreements as the defect is not a "curable defect."

In the Judgment, the Indian Supreme Court took NN Global through an X-ray scanner and demonstrated how NN Global proceeded on an incorrect understanding of the Stamp Act, Contract Act and most importantly, an erroneous understanding of principles underlying the Arbitration Act.

NN Global Misinterprets Inadmissible Agreement As Void Agreement

The Judgement held that a combined reading of sections 33 (impounding of unstamped instrument), 35 (unstamped instrument not admissible in evidence), 40 (power of collector to require proper payment of stamp duty) and 42 (admissibility of instrument in evidence once payment of duty is complete) of the Stamp Act demonstrates that inadequate payment of stamp duty is a defect that is ultimately curable, which was wrongly decided as incurable in NN Global. For instance, when a party relies on an unstamped agreement, a judicial authority would impound it under section 33, and under section 35, it would be inadmissible in evidence. However, under section 40, once proper stamp duty is paid by the party, the defect of non-payment of duty is cured, and under section 42, the agreement becomes admissible in evidence once stamp duty is paid.

Crucially, the Judgment clarified that an inadmissible agreement, for the purpose of section 35 of the Stamp Act, is not the same as a void agreement. The Indian Supreme Court explained that even a void agreement can be admissible in evidence if stamp duty is paid, although the same would be void for unrelated reasons, such as an agreement for an unlawful purpose. It follows, therefore, that an inadequately stamped agreement is not rendered void in the first place and is only inadmissible until the curable defect is cured.

On the issue of whether the courts have to deal with the objection as to payment of stamp duty, the Indian Supreme Court held that after the legislative introduction of section 11(6A) to the Arbitration Act, at the stage of section 11, the courts have to determine the existence of the arbitration agreement, while questions on payment of stamp duty, requiring detailed consideration, should be left to the tribunal. In deciding so, the Indian Supreme Court also found that earlier judgments of *SMS Tea Estate*s and *Garware Wall Ropes* were incorrectly decided as they held that the objection of inadequate stamp duty payment is to be done at the stage of section 11 itself and *Vidya Drolia's* holding on Section 11(6A) was incorrect.

Key Principles of Arbitration Identified By the Seven-Judge Bench

In deciding whether unstamped agreements are unenforceable, the Judgment considered the remit of courts at the threshold stage.

SEPARABILITY OF THE ARBITRATION AGREEMENT

The Indian Supreme Court emphasised the "substantive independence" of the arbitration agreement not only from the perspective of an arbitral tribunal ruling on its own jurisdiction (under section 16 of the Arbitration Act) but also in treating the arbitration agreement as being separate from the main (even if invalid) contract, as if, bearing separate signatures. The separability presumption holds good even in the context of the Stamp Act; an unstamped underlying contract has no impact on the arbitration agreement, and any objection to that effect by a party would have to be adjudicated by the arbitral tribunal and not a referral court under section 11 of the Arbitration

Act.

PRINCIPLE OF COMPETENCE-COMPETENCE

Following from the separability presumption is the principle of competence-competence based on which an arbitral tribunal exercises power to rule on its own jurisdiction if challenged, as enshrined in section 16 of the Arbitration Act. The Judgement holds that there is a negative aspect (i.e., requiring minimal interference from courts, hence, couched as negative) of competence-competence where courts should, at the outset refrain from deciding any such challenge and instead "… leave the issue to be decided by the arbitral tribunal in the first instance."

JUDICIAL INTERFERENCE UNDER THE ARBITRATION ACT

Although related to separability and competence-competence, in comparison to the former two, the issue of judicial interference has a longer and more uncertain journey, particularly section 11(6) of the Arbitration Act, around which judicial interference has swung like a pendulum. The Judgment traces this judicial and legislative evolution from SBP & Co. v. Patel Engineering Ltd. [(2005) 8 SCC 618] and National Insurance Co. Ltd. v. Boghara Polyfab Pvt. Ltd. [(2009) 1 SCC 267] representing too much judicial interference to the insertion of Section 11(6A) of the Arbitration Act by the Arbitration and Conciliation (Amendment) Act 2015 representing minimum judicial interference.

The Judgment holds that under section 11(6A) of the Arbitration Act, the scope of examination should be confined to the existence of an arbitration agreement. In order to determine the existence of an arbitration agreement, courts only have to consider "whether the underlying contract contains an arbitration agreement which provides for arbitration pertaining to the disputes which have arisen between the parties to the agreement". Importantly, the power of a court's examination has to be prima facie, and hence "[t]he referral court is not the appropriate forum to conduct a mini-trial by allowing the parties to adduce the evidence in regard to the existence or validity of an arbitration agreement". As a court's power of determination is only prima facie (as opposed to a "conclusive view" that a previous Supreme Court judgment of *Magic Eye* had suggested), the consequence is that such a prima facie view will not bind the arbitral tribunal or a court enforcing the arbitral award and it would be open for the arbitral tribunal also to examine the issue in greater depth. In contrast, if a court decides that a party should not be referred to arbitration, that of itself becomes a conclusive determination.

While this finding of the Judgment is aimed at further making India "arbitration friendly," it can be considered troublesome from the perspective of a party that has been dragged to arbitration when there is no subsisting arbitration agreement. Why should such a party, then, be dragged (non-consensually) before an arbitral tribunal to prove that it is not bound by any arbitration? Further, as the law stands, if a challenge to an arbitral tribunal's jurisdiction (under section 16 of the Arbitration Act) fails, the only remedy left is when challenging the award itself. While the policy reason behind that, of itself, is understandable, at least when making a referral of parties to arbitration at the outset – it is, in our view, the duty of courts to ascertain that, indeed, an arbitration agreement exists in a manner that is not mechanical or formalistic. The principle of "when in doubt, refer" (as postulated in this case and in the case of *Cox and Kings,* discussed below) may do a huge disservice to parties that were never meant to be referred to arbitration – having not consented to do so – but now in light of the Judgment being sent to do so only perhaps to be told later by the arbitral tribunal that they were not bound in the first place. This goes against

the very grain of arbitration which is supposed to be premised on consent and party autonomy. It would do well, therefore, for the courts to keenly examine, even if *prima facie*, whether a party can at all, be referred to arbitration.

PRACTICAL CONSEQUENCES OF A PRIMA FACIE DETERMINATION FOR JOINDER OF NON-SIGNATORIES

A week before the pronouncement, the Indian Supreme Court issued the five-judge bench judgment in Cox and Kings Ltd. v. SAP India Pvt. Ltd. & Anr. (**"Cox and Kings"**). Cox and Kings is a lengthy determination on the validity of the 'Group of Companies' doctrine in the jurisprudence of Indian arbitration. Without going into the Indian Supreme Court's findings on the doctrine, it may not be out of place to state that several paragraphs of Cox and Kings speak to the Judgment, particularly on the question of prima facie determination of the existence of an arbitration agreement where non-signatories are sought to be referred to arbitration. In the context of multiple non-signatories, this presents a unique and complex problem and, in some cases, requires a determination of facts which, according to Cox and Kings, an arbitral tribunal could get into.

When both these judgments are read, it is clear that the referral court (within the narrow scope of prima facie determination) will still have to play its part (and indeed, as the Judgment recognises) must play its part in identifying deadwood and non-existent arbitration agreements. The stamping saga having been laid to rest, both *Cox and Kings* and the Judgment make some fine reading on arbitration jurisprudence in India and provide clarity on many vexed issues that have plotted unique courses through case law over the years. One thing is clear: the Indian Supreme Court is keen on ensuring that it leaves fewer questions unanswered as it paves a new era, one judgment at a time.

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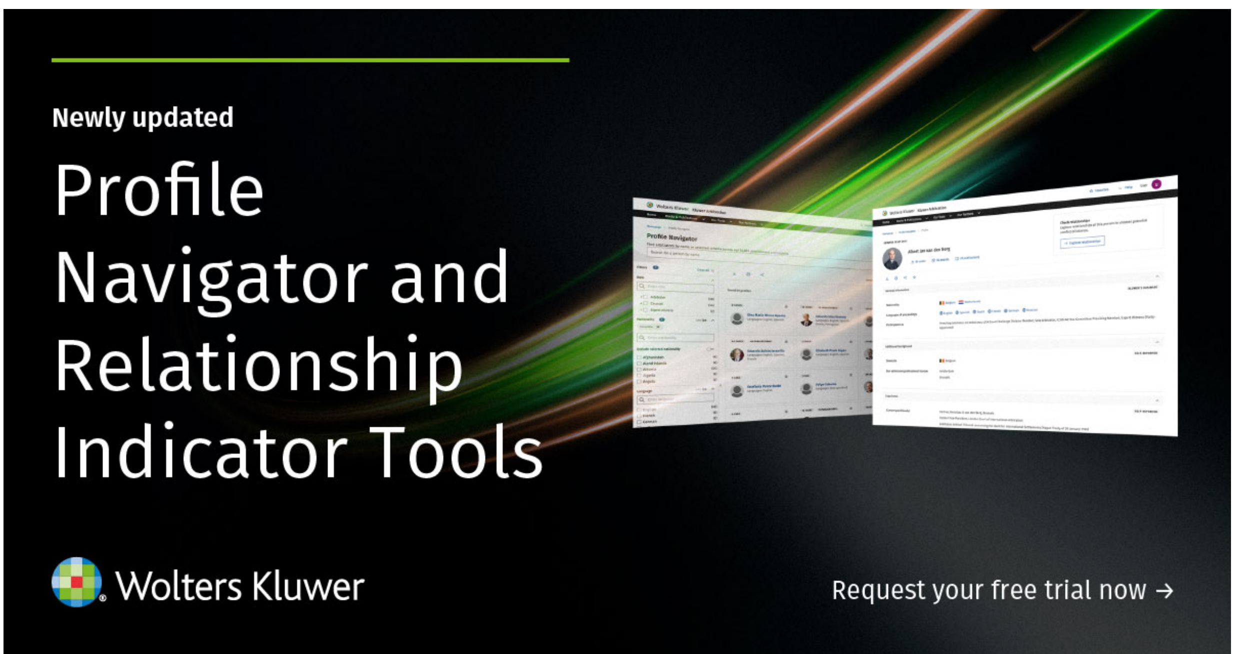

References

?1 A reference under section 8 originates when a party brings an action in a court, and the contesting party relies on an arbitration agreement and asks the court to refer the parties to arbitration. A reference under section 11 originates when parties fail to agree on the appointment of arbitrators for any set of reasons, which compels the party seeking reference to make an application to an Indian High Court or Supreme Court. A court in a section 8 reference has to look at the validity of an arbitration agreement while a court in a section 11 reference has to consider the existence of an arbitration agreement.

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