

Arbitration Clause in an unstamped contract is valid

INTRODUCTION:

Nearly after a decade of deciding that an arbitration clause contained in an unstamped or deficiently stamped contract, is not valid and hence not enforceable until such deficiency is removed, in the case of *SMS Tea Estates Vs. M/s Chandmari Tea Co. Pvt. Ltd.*¹, the Hon'ble Supreme Court overruled the said judgment in case of *SMS Tea Estates (supra)* and held that arbitration clause contained in an unstamped or deficiently stamped instrument, being an independent contract, is valid and enforceable. This has been held by a three judges' bench of the Hon'ble Supreme Court in the matter of *M/s N.N. Global Mercantile Pvt. Ltd. Vs. M/s Indo Unique Frame Ltd. & Ors.*². After holding as above, the Apex Court also referred the findings of a coordinate bench in the judgment of *Vidya Drolia & Ors. v. Durga Trading Corporation*³ to a constitution bench of five judges, for authoritative decision on the following question:

“Whether the statutory bar contained in Section 35 of the Indian Stamp Act, 1899 applicable to instruments chargeable to Stamp Duty under Section 3 read with the Schedule to the Act, would also render the arbitration agreement contained in such an instrument, which is not chargeable to payment of stamp duty, as being non-existent, unenforceable, or invalid, pending payment of stamp duty on the substantive contract/ instrument?”

FACTUAL BACKGROUND:

A work order dated 28.9.2015 was issued by Indo Unique, (Respondent) in favour of N.N. Global Mercantile Pvt. Ltd. (Appellant). The work order had following two Clauses:

“9. Security Deposit: You will submit the Bank Guarantee for Rs.5.00 crores for the average stock of washed coal lying at your stockyard. This Bank Guarantee can be issued from any nationalised Bank/first class bank, initially valid for a period of 18 (eighteen) months.”

¹ (2011) 14 SCC 66

² Civil Appeal No. 3802-3803/2020 decided by judgment dated 11.1.2021

³ Civil Appeal No. 2402/2009 decided by judgment dated 14.2.2020



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“10. Arbitration: In case of any dispute due to difference of opinion in interpretation of any clause or terms and conditions or meaning of the work or language the decision of the arbitrator appointed with mutual consent shall be treated as final and binding on both the parties.”

Before any work could actually be executed in terms of the work order, the bank guarantee issued by Respondent under the principal contract in favour of Karnataka Power Corporation Ltd. (“**KPCL**”) got invoked. The Respondent resultantly invoked the bank guarantee furnished by the Appellant under work order. Appellant filed a civil suit before the Commercial Court, Nagpur seeking declaration that Respondent was not entitled to encash the bank guarantee as the work order had not been acted upon. In the absence of any loss suffered by the Respondent, the invocation of bank guarantee was stated to be fraudulent. In the Commercial Court, Respondent filed an application under Section 8 of the Arbitration and Conciliation Act, 1996 (“**the Act**”) seeking reference of dispute to arbitration. This application was rejected by the Commercial Court vide order dated 18.1.2018 on the ground that the arbitration clause in the work order would not cover the bank guarantee and that due to non-performance of any part of the work order by the parties, jurisdiction of the Commercial Court was not ousted by the arbitration agreement. The Respondent filed a Writ Petition before the Hon’ble Bombay High Court to quash and set aside the order dated 18.1.2018 passed by the Commercial Court, Nagpur. The High Court vide judgment dated 30.9.2020 held that the application under Section 8 of the Act was maintainable in view of the admitted position that there was an arbitration agreement between the parties.

With respect to allegation of fraudulent invocation of the bank guarantee, the High Court held that since the said allegation did not constitute any criminal offence such a dispute could be resolved through arbitration. As regards the arbitration agreement being unenforceable due to the fact that the work order was unstamped, the High Court held that the issue could be resolved either section 11 of the Act or before the arbitral tribunal at appropriate stage.

With the aforesaid finding, the High Court allowed the writ petition and set aside the order dated 18.1.2018. Being aggrieved by the judgment and order dated 18.1.2018, the Appellant filed a Special Leave Petition before the Hon’ble Supreme Court of India, which framed following three issues:

- (i) *Whether an arbitration agreement would be enforceable and acted upon, even if the Work Order dated 28.09.2015 is unstamped and un-enforceable under the Stamp Act?*
- (ii) *Whether allegation of the fraudulent invocation of the bank guarantee is an arbitrable dispute?*
- (iii) *Whether a Writ Petition under Articles 226 and 227 of the Constitution would be maintainable to challenge an Order rejecting an application for reference to arbitration under Section 8 of the Arbitration Act?*

As regards the first issue, the Hon’ble Apex Court noted that the arbitration jurisprudence is based on the premise that parties to commercial contract containing arbitration agreement enter into two separate agreements – (i) substantive contract, which contains rights and obligations of the parties arising from the commercial transaction; (ii) the arbitration agreement which contains the binding obligation of the parties to resolve their disputes through the mode of arbitration. Taking cognizance of doctrine of separability and that of kompetenz – kompetenz, the Apex Court held that arbitration agreement is a separate and independent from substantive agreement underlying the contract in which it is embedded. Therefore, the arbitration agreement exists and can be acted upon

irrespective of whether the main/substantive contract is valid or not. The Court held that the non-payment or deficiency of stamp duty in the work order did not invalidate the main contract and such non-payment or deficient payment of stamp duty on an instrument is curable on payment of requisite stamp duty. The arbitration agreement contained in work order is independent distinct from the underlying contract. It was further held that no stamp duty is payable on the arbitration agreement and that the arbitration agreement would not be rendered invalid, unenforceable or non-existent even if substantive contract is not admissible in evidence or cannot be acted upon on account of non-payment of stamp duty. The Apex Court overruled its earlier judgment in the case of SMS Tea Estate (supra) besides holding that the finding in paragraph 22 & 29 of *Garware Wall Ropes Limited v. Coastal Marine Constructions and Engineering Limited*⁴ as well as para 92 of *Vidya Drolia (supra)* to be erroneous and not laying down the correct position in law. Accordingly, the said findings were referred to constitution bench of 5 judges for authoritative pronouncement on the said issue.

With respect to actions to be taken for adjudication of arbitrable disputes based on unstamped or deficiently stamped contract, the Court held that the same can be dealt with in following manner: –

- (i) Where the constitution of the tribunal takes place with consent of the parties or by a designated arbitration institution, the arbitral tribunal would be under obligation to impound the instrument and direct the parties to pay the requisite stamp duty (and penalty, if any) and obtain an endorsement from the concerned collector.
- (ii) Where an application is made under Section 11 before the court for appointment of arbitrator, the High Court or the Supreme Court, as the case may be, would impound the substantive contract and direct the parties to cure defects before the arbitral tribunal can adjudicate upon the contract.
- (iii) Where an application for reference of the matter to arbitration is filed under Section 8 in any proceedings pending before a judicial authority, judicial authority will make reference to arbitration with direction to the parties to have the substantive contracts stamped as per law.
- (iv) Where an application under Section 9 of the Act is made in respect of contract, which is deficiently stamped, the court would grant the interim relief to safeguard the subject matter of arbitration. However, the court would impound the substantive contract with direction to the concerned parties to take necessary steps for payment of requisite stamp duty in a time bound manner.

As regards issue no.2, the Apex Court took cognizance of its earlier pronouncements on the subject and held that all commercial disputes, either contractual or non-contractual, which can be adjudicated upon by a civil court in principal can be adjudicated and resolved through arbitration, unless it is excluded either expressly by statute, or by necessary implication. The Court held that civil aspect of the fraud is considered to be arbitrable and the only exception being a situation where the

⁴ 2019) 9 SCC 209

allegation is that the arbitration agreement itself is vitiated by fraud or fraudulent inducement, or the fraud goes to the validity of the underlying contract, and impeaches the arbitration clause itself.

On the third issue respect to maintainability of the writ petition, the Hon'ble Apex Court held that the same was not maintainable in view of the remedy being available under Section 37 (1) (a) of the Act which provides that an order refusing to refer the parties under Section 8 of the Act is appealable. In view of the admitted position regarding existence of arbitration agreement between the parties, the Court held that the parties may either appoint a sole arbitrator consensually failing which the application under Section 11 for appointment of arbitrator may be made to the High Court.

In conclusion, the Court set aside the judgment dated 30.9.2020 passed by the High Court and directed the Secretary General of the Hon'ble Supreme Court to impound the work order and forward it to the concerned Collector in Maharashtra for assessment of the Stamp Duty payable thereon with further direction for payment of the stamp duty assessed by the Appellant.

Conclusion

After this decision, there are two judgments holding contrary views *vis* the judgment in the case of Vidya Drolia and the judgment in NN Global Mecantile. Since both the judgments are of 3 judges' bench, there is an urgent need for the authoritative pronouncement by the constitution bench on the issue to avoid any confusion.

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