

# Validity of unstamped **ARBITRATION AGREEMENTS**



*The decision of the SC further fortifies the position that judicial intervention in arbitral matter, at least at the stage of reference, ought to be minimal.*



The ease of resolving disputes, without the rigors of legal technicalities and minimal judicial intervention, is one of the prime reasons why arbitration is a preferred mode of dispute resolution worldwide. The Supreme Court of India in *M/s. N.N. Global Mercantile Pvt. Ltd. v. M/s. Indo Unique Flame Ltd. & Others*<sup>1</sup> (**Global Mercantile Judgment**) has taken a positive step toward removing another technical hurdle, i.e. the requirement of stamping an arbitration agreement/substantive agreement to maintain the validity of the arbitration agreement.

The Supreme Court (SC) in *Global Mercantile Judgment*<sup>2</sup> has overruled its previous judgment in *SMS Tea Estates Pvt. Ltd. v. M/s. Chandmari Tea Co. Pvt. Ltd.*<sup>3</sup> (**SMS Tea Estates Judgment**), wherein it was inter alia held that (i) an arbitration agreement in an unstamped commercial contract cannot be acted upon, or is rendered un-enforceable in law; and (ii) an arbitration agreement would be invalid where the contract or instrument is voidable at the option of a party, such as under Section 19 of the Indian Contract Act, 1872 (**Contract Act**).

The SC also held the finding<sup>4</sup> in *Garware Wall Ropes Limited v. Coastal Marine Constructions and Engineering Limited*<sup>5</sup> (**Garware Wall Judgment**), (which followed the SMS Tea Estates Judgment), as erroneous. However, since the Garware Wall Judgment has been cited with approval by a coordinate bench of the SC (3 Judge Bench) in *Vidya Drolia & Ors. v. Durga Trading Corporation*<sup>6</sup>, it referred the issue<sup>7</sup> to a Constitution Bench of five judges.

The basis of the SC decision in *Global Mercantile Judgment* is that the arbitration agreement is independent from the substantive agreement containing it and the statute, in this case the Maharashtra Stamp Act, 1958 (**Maharashtra Stamp Act**), does not subject an arbitration agreement to Stamp Duty. Therefore, the non-stamping/insufficient stamping of the arbitration agreement or the substantive agreement will not affect the validity of the arbitration agreement and the same can be acted upon.

## BACKGROUND OF THE DISPUTE

The main Respondent, Indo Unique Flame Ltd. (**Indo Unique**) applied for and was granted the work of beneficiation/washing of coal for Karnataka Power Corporation Ltd (**KPCL**). Pursuant to this work order, a Bank Guarantee (**BG**) of ₹29.29 crore was furnished to KPCL by Indo Unique.

Thereafter, Indo Unique entered into a sub-contract by way of a work order with the Appellant, Global Mercantile Pvt. Ltd. (**Global Mercantile/Appellant**) for certain works like transportation of coal from its washery to its stockyard, siding, coal handling, etc. This work order contained a clause for furnishing a BG and an arbitration clause.<sup>8</sup> Accordingly, the Appellant had furnished a BG to SBI, Indo Unique's banker.

On account of disputes between Indo Unique and KPCL, the BG furnished by Indo Unique was invoked by KPCL. Thereafter, Indo Unique invoked the BG furnished by Global Mercantile.

A commercial suit was filed by the Appellant against Indo Unique, and the Bankers<sup>9</sup> before the Commercial Court, Nagpur, seeking a declaration that Indo Unique was not entitled to invoke the BG. The main ground was that no work was allotted under the work order and that no work was done, and no invoices were raised and accordingly Indo Unique did not suffer any losses. The invocation was fraudulent since it was not in accordance with the work order.

Indo Unique filed an application under Section 8 of the Arbitration and Conciliation Act, 1996 (Arbitration Act), but the Court rejected the application and held that the arbitration clause does not cover the BG since it was between the bankers for due performance of the contract. This was challenged by Indo Unique before the Bombay High Court (HC) by way of a Writ Petition.

The HC decided the Writ Petition in favor of Indo Unique and set aside the order of the Commercial Court, and inter alia held that:

<sup>1</sup> Judgment dated January 11, 2021 in C.A. No. 3802-3803 of 2020 ("Judgment").

<sup>2</sup> Para 6.8 and 6.9 of the judgment.

<sup>3</sup> (2011) 14 SCC 66.

<sup>4</sup> "the arbitration clause would be non-existent in law, and unenforceable, till Stamp Duty is adjudicated and paid on the substantive contract."

<sup>5</sup> (2019) 9 SCC 209

<sup>6</sup> Judgment dated December 14, 2020 in C.A. No. 2402 of 2019.

<sup>7</sup> "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, un-enforceable, or invalid, pending payment of stamp duty on the substantive contract / instrument?"

<sup>8</sup> Clause 9 and 10 of the Work Order dated September 28, 2015.

<sup>9</sup> SBI, Indo Unique's Banker and Union Bank of India, the Appellant's Banker.

- (i) A Section 8 application under the Arbitration Act is maintainable, since it is an admitted position that there was an arbitration agreement;
- (ii) Since, the dispute could be resolved by way of arbitration, a suit before a commercial court was not maintainable;
- (iii) Objection relating to arbitration agreement being unenforceable, on account of being unstamped, could be raised under Section 11 of the Arbitration Act or before the arbitral tribunal;

#### ISSUE BEFORE THE SC

The HC decision was challenged by Global Mercantile before the SC and amongst the three issues framed, one of the issues was, “Whether an arbitration agreement would be enforceable and acted upon, even if the Work Order 28.09.2015 is unstamped and un-enforceable under the Stamp Act?”

#### RULING OF THE SC

The SC reiterated the age-old principle that an arbitration agreement is a separate and distinct agreement, independent of the substantive commercial agreement containing it. The basis being the concept of separability and kompetenz-kompetenz. The SC referred to the decisions passed in the United Kingdom and France in this regard.<sup>10</sup> The SC took note of the law in the UK, that the courts would refer the parties to arbitration if it were satisfied that there exists an arbitration agreement and that it would not entertain dispute on the issue of jurisdiction until the arbitral tribunal has ruled on the same.

The SC took note of the fact that the legislative intent behind the Arbitration Act is minimal judicial interference.<sup>11</sup> The SC held that the question on whether the substantive agreement was voidable or not can be resolved through arbitration.<sup>12</sup>

Thereafter, the SC took note of the scheme of the Maharashtra Stamp Act<sup>13</sup> and the judicial decision on the subject<sup>14</sup> and arrived at the following conclusion:<sup>15</sup>



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<sup>10</sup> See: *Heyman v. Darwins Ltd* [1942] AC 356, *Bremer Vulkan Schiffbau und Maschinenfabrik v. South India Shipping Corporation* [1981] AC 909, *Harbour Assurance v. Kansa General International Insurance* [1993] 1 Lloyd's Rep. 455 (CA), *Lesotho Highlands Development Authority v. Impregilo SpA and others* [2005] UKHL 43; [2006] 1 A.C. 221 at [21], *Gosset v. Caparelli Cass.* [Civ. Lere, 7 May 1963 (*Dalloz*, 1963), 545], *Fiona Trust & Holding Corporation v. Privalov* [2007] EWCA Civ 20, and *Fili Shipping Co Ltd and others v. Premium Nafta Products Ltd and others* [2007] UKHL 40.

<sup>11</sup> See: *Section 5 of the Arbitration Act.*

<sup>12</sup> See: *Section 5 and Section 16 of the Arbitration Act, Para 7.7 to 7.13 of Uttarakhnad Purv Sainik Kalyan Nigam Ltd. v. Northern Coal Field Ltd. (2020) 2 SCC 455, Para 53 of A. Ayyasamy v. Parmasivam & Ors. (2016) 10 SCC 386.*

<sup>13</sup> See: *Section 3, Section 30, Section 32A, Section 33-37, Section 41, Section 58, Item 63 of Schedule I.*

<sup>14</sup> See: *Naina Thakkar v. Annapurna Builders (2013) 14 SCC 354, Avinash Kumar Chauhan v. Vijay Krishna Mishra, (2009) 2 SCC 532, Black Pearl Hotels (P) Ltd. v. Planet M. Retail Ltd., (2017) 4 SCC 498 and Ram Rattan v. Parma Nand AIR 1946 PC 51.*

<sup>15</sup> See: *Para 5.4 and 5.5. of the Judgment.*





The SC held that an arbitration agreement is not included in the list of instruments chargeable to Stamp Duty under the Maharashtra Stamp Act.



- (i) The stringent provisions of the Stamp Act are to protect the interest of the State,
- (ii) The provision of the Maharashtra Stamp Act, 1958, creates a statutory bar on an unstamped instrument being admitted in evidence or being acted upon,
- (iii) An unstamped instrument can be admitted in evidence if requisite stamp duty is paid,
- (iv) Once the object of payment of Stamp Duty is satisfied, the initial defect or irregularity cannot come in the way of a party making the claim, basis that instrument.

The SC, taking note of the SMS Tea Judgment,<sup>16</sup> observed that the said judgment was passed before the 2016 amendment. During that time, the Courts were permitted to decide certain threshold issues such as, whether the claim was time-barred, a stale claim, etc.<sup>17</sup> However, with the 2016 amendment, this position of law was overruled. The law, as it stands, is that at the pre-reference stage, there must be minimal judicial intervention, and the only issue to be decided would be the existence of the arbitration agreement, and nothing more.<sup>18</sup> The SC also took note of the Garware Wall Judgment, holding it to be erroneous.

The SC held that an arbitration agreement is not included in the list of instruments chargeable to Stamp Duty under the Maharashtra Stamp Act. On the basis of the doctrine of separability and the fact that arbitration agreement is not chargeable to Stamp Duty, the SC held that there is no legal impediment to the enforceability of the arbitration agreement, pending payment of Stamp Duty on the substantive contract. However, it also held that the adjudication of the rights and obligation under the unstamped/deficiently stamped commercial agreement would not proceed till the mandatory provisions of the Stamp Act is complied with.

Since a different position of law had been laid down by the SC in SMS Tea Judgment and Garware Wall Judgment and affirmed by a co-ordinate bench in Vidya Drolia (Supra), the SC referred the issue to a Constitution Bench of five judges.

The SC also answered the question as to who would impound the instrument, wherein there is an arbitration clause, under Section 33 and 34 of the Maharashtra Act and pass necessary directions.

- (i) **Arbitral Tribunal:** The arbitral tribunal will impound the instrument and pass necessary

<sup>16</sup> See: Para 11, 12, 13, 15, 16, 19 and 21 of the SMS Tea Judgment.

<sup>17</sup> See: *SBP & Co. v. Patel Engineering Ltd.* (2005) 8 SCC 618, *National Insurance Co. v. Bophara Polyfab* (2009) 1 SCC 267, *Master Construction Company v. Union of India* (2011) 12 SCC 357.

<sup>18</sup> See: *Duro Felguera v. Gangavaram Port Ltd* (2017) 9 SCC 729 and *Mayavati Trading Private Limited v. Pradyut Deb Burman* (2019) 8 SCC 714.

directions, where the Arbitral Tribunal is appointed without intervention of the Court.

- (ii) High Court or Supreme Court: The Supreme Court or High Court, can impound the instrument and pass necessary direction, while exercising jurisdiction under Section 11 of the Arbitration Act.
- (iii) Judicial Authority: A judicial authority hearing an application under Section 8 of the Arbitration Act, will refer the matter to arbitration and direct parties to have the substantive agreement stamped in accordance with the relevant Stamp Act.

The SC also held that a Court hearing an application under Section 9 of the Arbitration Act, can impound the substantive agreement on the ground of it being unstamped or insufficiently stamped and at

the same time pass necessary orders to safeguard the subject matter of the arbitration.

#### CONCLUSION

While the SC set aside the HC order on a technical ground, the substantive decision of the HC was succinctly clarified and affirmed by the SC. The decision of the SC further fortifies the position that judicial intervention in arbitral matter, at least at the stage of reference, ought to be minimal. Having said that, this decision of the SC viz. the issue of validity of an arbitration agreement on account of being unstamped or improperly or deficiently stamped, will now be finally put to rest by the five judge Constitution Bench of the SC.

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