



A sneak peek of the conflicting view taken by Full Bench of the Hon'ble Supreme Court on whether Arbitration Agreement can be acted upon in an un-stamped commercial contract, referred to be decided by a Constitution Bench

CASE NOTE

N.N. Global Mercantile Pvt. Ltd. v/s Indo Unique Flame Ltd. & Ors.

On 11th January 2021, a three-judge bench of the Hon'ble Supreme Court of India (*Hon'ble Mr. Justice D. Y. Chandrachud, Mrs. Indu Malhotra and Mrs. Indira Banerjee*) in the case of *N.N. Global Mercantile Pvt. Ltd. v/s Indo Unique Flame Ltd. & Ors.*¹ was of the view that there is no legal impediment to the enforceability of the arbitration agreement, pending payment of Stamp Duty on the substantive contract. However, the adjudication of the rights and obligations under the substantive contract would proceed only upon complying with the mandatory provision of the Stamp Act. This view stood contrary to the law laid down by Division Bench of Hon'ble Supreme Court in *SMS Tea Estates Pvt. Ltd. v. Chandmari Tea Company Pvt. Ltd.*² followed by another Division Bench of Hon'ble Supreme Court in *Garware Wall Ropes Ltd. v. Coastal Marine Constructions & Engineering Ltd.*³ and a three-judge bench of the Hon'ble Supreme Court in the case of *Vidya Drolia & Ors. v. Durga Trading Corporation*⁴ that, the arbitration clause would be non-existent and unenforceable, till Stamp Duty is adjudicated and paid on the substantive contract. The three-judge bench of the Hon'ble Supreme Court were of the considered view that the finding in SMS Tea Estate is not the correct position in law.

Facts

- Indo Unique (Respondent No.1), was awarded a contract for beneficiation / washing of coal by Karnataka Power Corporation Ltd. ("KPCL") in an open tender. In accordance with the terms of the contract, a Bank Guarantee of Rs.29.29 Crores was furnished by Indo Unique to KPCL.
- Indo Unique subcontracted with N.N. Global Mercantile (the Appellant) for transportation of coal from its washery to the stockyard, sliding, coal handling and loading into wagons. A Bank Guarantee of Rs.3.36 Crores was furnished by N.N. Global Mercantile to Indo Unique. The sub-contract contained an arbitration clause which reads as under:

"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 of language the decision of the arbitrator appointed with mutual consent shall be treated as final and binding on both the parties".

- Due to certain disputes and difference which arose in the main contract, KPCL invoked the Bank Guarantee furnished by Indo Unique. Subsequently, Indo Unique also invoked the Bank Guarantee furnished by N.N. Global Mercantile.
- Upon invocation, N.N. Global Mercantile filed a Suit against Indo Unique before the Commercial Court, Nagpur on the ground that Indo Unique was not entitled to invoke the Bank Guarantee since the

¹ Civil Appeal Nos.3802 - 3803/2020 (arising out of SLP (C) No.1312-13133 of 2020)

² 2011 (14) SCC 66 – delivered on 20th July 2011

³ 2019 SCC OnLine SC 515 – delivered on 10th April 2019

⁴ C.A. No.2402/2019 – delivered on 14th December 2020

sub-contract had not been acted upon. The Commercial Court passed an ex-parte interim Order directing status quo to be maintained in respect of invocation of the Bank Guarantee. Indo Unique in turn filed an Application under Section 8 of the Arbitration & Conciliation Act, 1996 (*“the Act”*) seeking reference of disputes to arbitration. The Commercial Court dismissed the Application under Section 8 and ruled in favour of the N.N. Global Mercantile.

- Indo Unique preferred a Civil Revision Petition before the Hon’ble Bombay High Court which was subsequently withdrawn with liberty to file a Writ Petition under Articles 226 and 227 of the Constitution of India.
- The Hon’ble Bombay High Court in its Judgment dated 30th September 2020 held that since the existence of an arbitration agreement was an admitted position, the Application under Section 8 was maintainable. Further, as regards fraudulent invocation of Bank Guarantee, it was held that the allegation of fraud does not constitute a criminal offence and hence, dispute can be resolved through arbitration. In so far as payment of Stamp Duty was concerned, it was held that the issue can be raised in an application under Section 11 of the Act or before the arbitral tribunal. In view thereof, the Writ Petition was allowed.
- Aggrieved by the decision of the Hon’ble Bombay High Court, N.N. Global Mercantile preferred a Special Leave Petition before the Hon’ble Supreme Court of India, which set aside the Judgment of the Hon’ble Bombay High Court on the ground of maintainability of the Writ Petition, when a statutory Appeal under the Arbitration Act and Commercial Courts Act was available.

The Issue

The interesting issue that arose for the consideration of the Hon’ble Supreme Court, amongst other issues is as follows:

Whether an arbitration agreement would be non-existent in law, invalid or un-enforceable if the substantive commercial contract in which the arbitration agreement is embedded has not been sufficiently stamped as per the relevant Stamp Act?

Jurisprudential Background

- i. **The Hon’ble Supreme Court in *SMS Tea Estates Pvt. Ltd. v. Chandmari Tea Company Pvt. Ltd.* (Division Bench decision – delivered on 20th July 2011) Held in para 22 and 32**

22. We may therefore sum up the procedure to be adopted where the arbitration clause is contained in a document which is not registered (but compulsorily registrable) and which is not duly stamped:

22.1 The court should, before admitting any document into evidence or acting upon such document, examine whether the instrument/document is duly stamped and whether it is an instrument which is compulsorily registerable.

22.2 If the document is found to be not duly stamped, Section 35 of Stamp Act bars the said document being acted upon. Consequently, even the arbitration clause therein cannot be acted upon. The court should then proceed to impound the document under Section 33 of the Stamp Act and follow the procedure under Section 35 and 38 of the Stamp Act.

22.3 If the document is found to be duly stamped, or if the deficit stamp duty and penalty is paid, either before the Court or before the Collector (as contemplated in section 35 or 40 of the Stamp Act), and the defect with reference to deficit stamp is cured, the court may treat the document as duly stamped.

22.4 Once the document is found to be duly stamped, the court shall proceed to consider whether the document is compulsorily registrable. If the document is found to be not compulsorily registrable, the court can act upon the arbitration agreement, without any impediment.

22.5 If the document is not registered, but is compulsorily registrable, having regard to section 16(1)(a) of the Act, the court can de-link the arbitration agreement from the main document, as an agreement independent of the other terms of the document, even if the document itself cannot in any way affect the property or cannot be received as evidence of any transaction affecting such property. The only exception is where the respondent in the application demonstrates that the arbitration agreement is also void and unenforceable, as pointed out in para 8 above. If the respondent raises any objection that the arbitration agreement was invalid, the court will consider the said objection before proceeding to appoint an arbitrator.

22.6 Where the document is compulsorily registrable, but is not registered, but the arbitration agreement is valid and separable, what is required to be borne in mind is that the Arbitrator appointed in such a matter cannot rely upon the unregistered instrument except for two purposes, that is (a) as evidence of contract in a claim for specific performance and (b) as evidence of any collateral transaction which does not require registration.

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32. In view of the above this appeal is allowed, the order of the High Court is set aside and the matter is remitted to the learned Chief Justice of Guwahati High Court to first decide the issue of stamp duty, and if the document is duly stamped, then appoint an arbitrator in accordance with law.

- ii. **The Hon'ble Supreme Court in *Garware Wall Ropes Ltd. v. Coastal Marine Constructions & Engineering Ltd.* (Division Bench decision – delivered on 10th April 2019)** followed the decision of *SMS Tea Estates* and held as follows

26. It will be seen that neither in the Statement of Objects and Reasons nor in the Law Commission Report is there any mention of *SMS Tea Estates* (supra). This is for the very good reason that the Supreme Court or the High Court, while deciding a Section 11 application, does not, in any manner, decide any preliminary question that arises between the parties. The Supreme Court or the High Court is only giving effect to the provisions of a mandatory enactment which, no doubt, is to protect revenue. *SMS Tea Estates* (supra) has taken account of the mandatory provisions contained in the Indian Stamp Act and held them applicable to judicial authorities, which would include the Supreme Court and the High Court acting under Section 11. A close look at Section 11(6A) would show that when the Supreme Court or the High Court considers an application under Section 11(4) to 11(6), and comes across an arbitration clause in an agreement or conveyance which is unstamped, it is enjoined by the provisions of the Indian Stamp Act to first impound the agreement or conveyance and see that stamp duty and penalty (if any) is paid before

the agreement, as a whole, can be acted upon. It is important to remember that the Indian Stamp Act applies to the agreement or conveyance as a whole. Therefore, it is not possible to bifurcate the arbitration clause contained in such agreement or conveyance so as to give it an independent existence, as has been contended for by the respondent. The independent existence that could be given for certain limited purposes, on a harmonious reading of the Registration Act, 1908 and the 1996 Act has been referred to by Raveendran, J. in SMS Tea Estates (supra) when it comes to an unregistered agreement or conveyance. However, the Indian Stamp Act, containing no such provision as is contained in Section 49 of the Registration Act, 1908, has been held by the said judgment to apply to the agreement or conveyance as a whole, which would include the arbitration clause contained therein. It is clear, therefore, that the introduction of Section 11(6A) does not, in any manner, deal with or get over the basis of the judgment in SMS Tea Estates (supra), which continues to apply even after the amendment of Section 11(6A).

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29. When an arbitration clause is contained “in a contract”, it is significant that the agreement only becomes a contract if it is enforceable by law. We have seen how, under the Indian Stamp Act, an agreement does not become a contract, namely, that it is not enforceable in law, unless it is duly stamped. Therefore, even a plain reading of Section 11(6A), when read with Section 7(2) of the 1996 Act and Section 2(h) of the Contract Act, would make it clear that an arbitration clause in an agreement would not exist when it is not enforceable by law. This is also an indicator that SMS Tea Estates (supra) has, in no manner, been touched by the amendment of Section 11(6A).

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45. One reasonable way of harmonising the provisions contained in Sections 33 and 34 of the Maharashtra Stamp Act, which is a general statute insofar as it relates to safeguarding revenue, and Section 11 (13) of the 1996 Act, which applies specifically to speedy resolution of disputes by appointment of an arbitrator expeditiously, is by declaring that while proceeding with the Section 11 application, the High Court must impound the instrument which has not borne stamp duty and hand it over to the authority under the Maharashtra Stamp Act, who will then decide issues qua payment of stamp duty and penalty (if any) as expeditiously as possible, and preferably within a period of 45 days from the date on which the authority receives the instrument. As soon as stamp duty and penalty (if any) are paid on the instrument, any of the parties can bring the instrument to the notice of the High Court, which will then proceed to expeditiously hear and dispose of the Section 11 application. This will also ensure that once a Section 11 application is allowed and an arbitrator is appointed, the arbitrator can then proceed to decide the dispute within the time frame provided by Section 29A of the 1996 Act.

iii. The Hon’ble Supreme Court in *Vidya Drolia & Ors. v. Durga Trading Corporation & Ors. v. Durga Trading Corporation* (Full Bench decision delivered on 14th December 2020)

Following the precedent laid down in *Garware Wall Ropes*, it was held that the existence and validity of an arbitration agreement are intertwined, and an arbitration agreement does not exist if it is illegal or does not satisfy the mandatory legal requirements. An invalid agreement is no agreement.

Reasons that prompted a contrary view

- *SMS Tea Estates* Judgment was passed on an application filed under Section 11 of the Arbitration Act 1996 for reference of disputes to arbitration prior to the 2015 Amendment being passed.

- Post Amendment and insertion of Section 11(6A) in the Arbitration Act, the same issue came up for reconsideration in the case of *Garware Wall Ropes*, which followed the principle enunciated in *SMS Tea Estates*.
- The Arbitration Agreement is an independent and distinct agreement from the underlying commercial contract.
- Section 3 of the Maharashtra Stamp Act does not subject an arbitration agreement to payment of stamp duty, unlike other agreements enlisted in the schedule to the Act.
- On the basis of doctrine of separability, the arbitration agreement being a separate and distinct agreement from the underlying commercial contract, the arbitration agreement would not be rendered invalid, unenforceable 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.
- A voidable contract would also not affect the validity of the arbitration agreement as the allegations made by a party that the underlying contract has been obtained by coercion, fraud or misrepresentation must be proved by leading evidence on the issue. These issues can certainly be adjudicated through arbitration.
- On the issue of which authority can exercise the power of impounding the unstamped / insufficiently stamped instrument where the underlying commercial contract contains an arbitration clause, the Hon'ble Court was of the view that:
 - (i) Where appointment of arbitral tribunal is consensual – the arbitral tribunal to impound and direct the parties to pay the requisite stamp duty
 - (ii) Where appointment is under Section 11 of the Arbitration Act – Court to appoint arbitrator and impound the underlying commercial contract before arbitrator can adjudicate upon the contract.
 - (iii) Where application is made under section 8 of the Arbitration Act - the judicial authority will make the reference to arbitration; however, in the meanwhile, the parties would be directed to have the underlying commercial contract stamped so that the rights and obligations emanating therefrom can be adjudicated upon.
 - (iv) Where application is made under section 9 of the Arbitration Act – the Court would grant ad-interim relief to safeguard the subject matter of the arbitration and impound the underlying commercial contract for payment of requisite stamp duty, within a time bound period.

The Reference to Constitution Bench

“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?”

MKA Views

According to us this judgment will make little or no difference on the practical side. There is no running away from the fact that Stamp duty has to be paid either when the document is impounded by the Court or the Tribunal as the case may be.

Following the decision of *Garware Wall Ropes*, Hon'ble Courts started to impound the document chargeable with duty brought before a Section 11 Court and awaited the adjudication of the stamp authorities before passing final order appointing Arbitral Tribunal.

Interestingly, the Full Bench decision of the Bombay High Court in the case of *Gautam Landscapes Pvt. Ltd. vs Shailesh Shah & Anr.*⁵ (prior to *Garware Wall Ropes*) held that in view of the Amendment to Section 11(6A) of the Arbitration Act it would not be necessary for the Court before considering and passing final order on an application under Section 11(6) of the Act to await the adjudication by the stamp authorities. This question having been answered by the Hon'ble Supreme Court in *Garware Wall Ropes* to the contrary, was held to be incorrectly held in the case of *Gautam Landscapes*.

The views of the Full Bench of the Supreme Court in *N.N. Global Mercantile Pvt. Ltd. v/s Indo Unique Flame Ltd. & Ors.* echo the views expressed by the Full Bench of the Bombay High Court in the decision of *Gautam Landscapes*.

It is to be seen whether the Constitution Bench of the Supreme Court authoritatively settles the reference by confirming the views expressed by the Supreme Court in the case of *Garware Wall Ropes* or *N.N. Global Mercantile Pvt. Ltd.*


⁵ 2019 SCC Online BOM 563

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