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SUPREME COURT REFERS THE ISSUE OF ENFORCEABILITY OF ARBITRATION CLAUSE IN AN UNSTAMPED CONTRACT TO A CONSTITUTION BENCH

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A three-judge bench of the Hon'ble Supreme Court in the case of M/s N.N. Global Mercantile Pvt. Ltd. v. M/s Indo Unique Flame Ltd. & Ors by judgment dated 11.01.2021 expressed a differing view on the issue of invalidity and unenforceability of an arbitration agreement in an unstamped underlying contract and referred the issue to a Constitution Bench in light of the conflicting view it expressed on a well-settled issue. The Supreme Court had previously held the view that the court will not act on an arbitration clause in an unstamped agreement unless the stamp duty was paid and passed detailed directions as to the procedure to be adopted where the agreement /instrument was not properly stamped, including impounding of the unstamped agreement / instrument. The present three-judge Bench did not agree with this position and overruled the previous precedent on the issue.

BACKGROUND OF THE DISPUTE

Indo Unique Flame Ltd. (Indo Unique), entered into a sub-contract with N.N. Global Mercantile Pvt. Ltd (Global Mercantile), which was termed as Work Order dated 28.09.2015 (Work Order). In terms of the Work Order, Global Mercantile furnished a Bank Guarantee to Indo Unique. Clause 10 of the Work Order incorporated an arbitration clause.

Indo Unique invoked the Bank Guarantee furnished by Global Mercantile and the same was assailed by Global Mercantile by filing a civil suit before the Commercial Court, Nagpur. Indo Unique filed an application under Section 8 of the Arbitration and Conciliation Act, 1996 (the Act) seeking reference of the disputes to arbitration. The Commercial Court vide order dated 18.01.2018 rejected the application under Section 8 of the Act holding that the Bank Guarantee was an independent contract.

The order dated 18.01.2018 was assailed by Indo Unique by filing a Writ Petition. The Bombay High Court by its judgment dated 30.09.2020 held that the Writ Petition is maintainable and further allowed the application under Section 8 of the Act. It held that the issue of Work Order not being stamped can be raised at the stage of Section 11 of the Act or before the Arbitral Tribunal at the appropriate stage. The order dated 18.01.2018 was set aside.

The matter travelled to the Supreme Court from the judgment dated 30.09.2020.

ANALYSIS AND DECISION OF THE COURT

In relation to the issue of whether an arbitration agreement would be valid, enforceable, and acted upon even if the underlying agreement is unstamped and unenforceable, the Court based its findings primarily on two principles:

- a. Doctrine of separability: An arbitration agreement is a separable and distinct agreement, independent of the underlying contract in which it is embedded. The invalidity, ineffectiveness or termination of the underlying contract would not affect the arbitration agreement except in cases where the arbitration agreement is directly impeached on the ground of it being *void ab initio*.
- b. The Maharashtra Stamp Act, 1958 does not subject an arbitration agreement to payment of stamp duty. Further, the non-payment or deficiency of stamp duty even on the underlying contract does not invalidate it, as such deficiency can be cured on payment of the requisite stamp duty.

The Court therefore held that the arbitration agreement would not be rendered invalid, unenforceable or non-existent even if the underlying contract cannot be acted upon on account of non-payment of stamp duty. However, the adjudication of rights and obligations under the substantive/underlying contract would not proceed before complying with the mandatory provisions of the stamp duty laws.

Hence, in view of the above conclusions, the Court expressly overruled SMS Tea Estate Pvt Ltd v Chandmari Tea Co. Pvt Ltd, (2011) 14 SCC 66 (SMS Tea), which observed that an arbitration clause is independent of the other terms of the contract and held that (i) an unstamped arbitration agreement cannot be acted upon, and (ii) an arbitration agreement would be invalid where the contract is voidable at the option of a party.

The Court further noted that SMS Tea was followed in Garware Wall Ropes Ltd v Coastal Marine Construction and Engineering Ltd, (2019) 9 SCC 209 (Garware) which held that an arbitration clause contained in a contract would exist as a matter of law only if the underlying contract is duly stamped. Garware also held that it is not possible to bifurcate the arbitration clause contained in the arbitration agreement so as to give it an independent existence.

The Court held that Garware does not lay down the correct position of law. Since Garware was affirmed by a three-judge Bench of the Court in Vidya Drolia v Durga Trading Corporation, 2020 SCC OnLine SC 1018, the Court referred the issue to a Constitution Bench of five judges as the three-judge Bench had taken a differing view on the issue.

COMMENT

The Court appears to have taken a pro-arbitration approach to not impede the arbitral process on account of technicalities. The issue of whether an arbitration agreement contained in an unstamped instrument will be rendered non-existent, unenforceable or invalid, pending the payment of stamp duty on the underlying contract/instrument, which was well-settled since SMS Tea (2011), will now be decided by a Constitution Bench.

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