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Validity and Enforcement of Arbitration Agreements in Unstamped Instruments: N.N. Global Mercantile Private Limited v Indo Unique Flame Ltd And Others

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Introduction

In a recent judgment, a constitution bench of the Supreme Court of India, known as the "Larger Bench," ruled in the case of N.N. Global Mercantile Private Limited v Indo Unique Flame Ltd and Others, with a majority decision of 3:2. The ruling stated that an unstamped instrument, which is subject to stamp duty and contains an arbitration clause, cannot be considered a legally enforceable contract under Section 2(h) of the Indian Contract Act 1872. Consequently, it is not enforceable under Section 2(g) of the Contract Act.

Furthermore, the judgment determined that the provisions of Sections 33 and the restriction outlined in Section 35 of the Stamp Act 1899, which apply to instruments liable for stamp duty under Section 3 in conjunction with the Schedule of the Stamp Act, would render the arbitration agreement within such an instrument legally non-existent, unless the instrument is properly validated under the Stamp Act.

This decision was made after considering conflicting judgments from coordinate benches of the Supreme Court of India.

The controversy surrounding the absence of stamping in commercial contracts and its impact on arbitration agreements has been long-standing. The Supreme Court, while adjudicating a Section 11 Application under the Arbitration and Conciliation Act 1996 in the SMS Tea Estates case, held that the court could not act on an unstamped substantive agreement or instrument unless the required stamp duty and penalty were paid. This effectively meant that the arbitration agreement within an unstamped instrument could not be enforced.

Following this, in the Garware Wall Ropes Ltd v Coastal Marine Construction & Engg. case, it was reiterated that an arbitration agreement within an unstamped agreement could not be presented as evidence and thus, could not be invoked. However, the court acknowledged that

the stamp duty deficiency could be rectified by paying the required amount, allowing the invocation to proceed, albeit with a potential delay in appointing an arbitrator.

Subsequently, in *N.N. Global Mercantile (P) Ltd. v. Indo Unique Flame Ltd* ("NN Global -1"), a three-judge bench overruled the precedent set in *SMS Tea*, asserting that the arbitration agreement is an independent contract not subject to stamp duty. Consequently, non-payment of stamp duty would not invalidate the arbitration clause. The bench also provided guidelines for handling unstamped Agreements at the pre-reference stage.

This decision brought temporary resolution to the longstanding controversy, recognizing the importance of minimal interference in arbitration matters. It acknowledged both the principles of severability and *Kompetenz-Kompetenz*.

However, a subsequent coordinate bench in *Vidya Drolia v Durga Trading Corporation* chose to follow the decision in *Garware*, asserting that the law laid down in *Garware* was not in error.

Given this backdrop, a reference was made to the Larger Bench to assess the correctness of the decision in *N.N. Global-1*.

The central issue before the Larger Bench was whether the statutory prohibition in Section 35 of the Stamp Act, applicable to instruments chargeable with stamp duty under Section 3 along with the Schedule to the Stamp Act, would also render the arbitration agreement within such an instrument, which is not subject to stamp duty, as legally non-existent, unenforceable, or invalid pending payment of stamp duty on the substantive contract or instrument.

The Majority Judgment, delivered by Hon'ble Justice Joseph Kurian and Hon'ble Justice Aniruddha Bose, with a concurring judgment by Hon'ble Justice CT Ravikumar, affirmed the view established in *SMS Tea* and followed in *Garware* as the correct legal position. It further held that *N.N. Global-1* was erroneously decided as it overruled *SMS Tea*.

The majority concluded that an unstamped contract or instrument, subject to stamp duty and potentially containing an arbitration clause, cannot be deemed a legally enforceable contract.

Therefore, such a contract, along with its arbitration agreement, cannot be considered legally valid.

The majority also recognized that in an application under Section 11 of the Arbitration Act, the court is only required to verify the existence of an arbitration agreement. However, it held that an unstamped or under-stamped agreement is effectively void, thus failing the test of existence.

Additionally, the majority emphasized that a court acting under Section 11 of the Arbitration Act is obligated to act in accordance with Section 33 of the Stamp Act and impound the unstamped contract. It clarified that the court could proceed with the Section 11 Application only after rectifying the stamp duty deficiency.

The Minority Judgments, delivered by Hon'ble Justice Ajay Rastogi and Hon'ble Justice Hrishikesh Roy, upheld the overruling of the decision in SMS Tea. They reiterated the stance in NN Global-1, asserting that non-stamping or insufficient stamping of the substantive contract or instrument would not render the arbitration agreement legally non-existent and unenforceable for arbitration references.

They further stated that the presence of a copy or certified copy of an arbitration agreement, whether unstamped or insufficiently stamped at the pre-reference stage, is a legally enforceable document for the appointment of an Arbitrator under Section 11(6A) of the Arbitration Act.

The Minority Judgments also contended that matters such as stamping, impounding, and other preliminary or debatable issues, including the sufficiency of stamp duty and the validity of the arbitration agreement, should be referred to the arbitral tribunal for resolution, in accordance with Section 16 of the Arbitration Act.

In conclusion, the Majority Judgment reinstates the legal position established in SMS Tea. It relies on a technical interpretation of the relevant statutes, and its reasoning is sound in this regard.

However, the decision brings about two significant outcomes: increased judicial intervention at the pre-reference stage and potential delays in appointing arbitrators. This is particularly

pertinent in India, where the post-impounding adjudication process under the Stamp Act can be arduous and time-consuming. In this context, providing directions to Stamp Act authorities for time-bound action may have been beneficial.

Interestingly, the Majority Judgment does not address applications under Section 9 of the Arbitration Act. Nonetheless, if the stance in the Majority Judgment and SMS Tea is applied, even applications under Section 9 should not be entertained, nor should orders be passed, until the stamp duty deficiency is rectified. After all, an agreement cannot be void for one purpose but valid for another, especially when no such distinction is made in the Stamp Act.

The Minority Judgments, on the other hand, uphold the principles of severability and separability of an arbitration agreement. This aligns more closely with international standards. Arguably, the approach of minimizing judicial interference, as evident in the Minority Judgments, appears to be more in line with the genuine intent and spirit of the Arbitration Act.

The decision by the Larger Bench has once again raised questions about the interplay between substantive contracts and their included arbitration clauses. Moving forward, parties will need to be conscientious about adhering to stamp duty requirements. Additionally, the manner in which arbitration agreements are executed may require re-evaluation to consider whether a separate arbitration agreement should be established to protect the rights of the involved parties.

While the Stamp Act primarily serves fiscal purposes and benefits revenue collection, the fact that the non-payment of requisite stamp duty is a correctable defect suggests that an interpretation in line with expediting arbitration might have been more fitting for positioning India as a hub for international arbitration.