

RECENT JUDGEMENT BY THE CONSTITUTION BENCH OF THE SUPREME COURT OF INDIA: UNSTAMPED ARBITRATION AGREEMENTS ARE NOT VALID IN LAW

1. INTRODUCTION

On 25 April 2023, a Constitution Bench of the Supreme Court of India, in a reference from *NN Global Mercantile Pvt Ltd v Indo Unique Flame Pvt Ltd*,¹ held by a 3:2 majority, that unstamped arbitration agreements are not valid in law.² This is one of the pivotal judgements on the issue of validity of arbitration agreements under the Arbitration and Conciliation Act, 1996 (“**Arbitration Act**”), as amended.

2. UNDERSTANDING THE RATIO

The Supreme Court has held that arbitration agreements, although independent contracts, are exigible to stamp duty, and therefore non-payment of the stamp duty (whether the agreement is a separate contract or a clause within a contract) would render such an agreement unenforceable.

The Constitution Bench held that the views expressed by the Supreme Court in *SMS Tea Estates Pvt Ltd v Chandmari Tea Company Private Limited*,³ reiterated in *Garware Wall Ropes Limited v Coastal Marine Constructions Private Limited*,⁴ and approved in *Vidya Drolia v Durga Trading Corporation*,⁵ are correct.

The effect of this verdict is that a dispute arising from an unstamped agreement cannot even be referred to arbitration until the agreement is stamped in accordance with the stamp acts.

2.1. Independent nature of the arbitration agreement

The primary basis for the Judgement is that an arbitration agreement, being an independent agreement, would itself attract stamp duty, and based on this view, the Constitution Bench reformulated the question under reference, as follows: “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,

¹ (2014) 4 SCC 379.

² Judgement dated 25 April 2023 in Civil Appeal Nos. 3802-3803 of 2020.

³ (2011) 14 SCC 66.

⁴ (2019) 9 SCC 209.

⁵ (2021) 2 SCC 1.

~~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?"~~

In its Judgement, the Supreme Court first referred to section 2(h) of the Indian Contract Act, 1872, which states that an agreement enforceable by law is a contract. It then referred to the provisions of the Indian Stamp Act, 1899 ("**Stamp Act**"), which envisage that any agreement which is unstamped, is unenforceable in law and, is said not to "exist" and, cannot be "acted upon" as a valid contract. Consequently, the Apex Court held that an arbitration agreement, whether independently or as a clause in another contract which is not stamped, would not be said to "exist" and could not be "acted upon" by a court, for referring disputes to arbitration.

2.2. Introduction of Section 11(6A) and judicial intervention

Having held as above, the Supreme Court dealt with Section 11(6A) of the Arbitration Act which mandates that a court may only determine the "existence" of an arbitration agreement to refer disputes to arbitration. In this regard, the Constitution Bench has adopted a practical interpretation of the word "existence" to mean existence in law, as per the essential ingredients of a contract. The Apex Court held that an agreement which is not enforceable or valid in law cannot be said to "exist" in law. As per the Stamp Act, unstamped or insufficiently stamped arbitration agreements cannot be said to "exist" or be acted upon.

While the intention behind introducing section 11(6A) was to minimise judicial intervention so that the arbitration proceedings were not thwarted at the threshold, including in respect of objections related to stamp duty, the Supreme Court has prioritised the court's strict adherence to the Stamp Act over this intention, in this Judgement.

The Supreme Court cited *SMS Tea Estates* with approval to hold that—unlike the proviso to Section 49 of the Registration Act, 1908, which allows an unregistered document to be used to prove a collateral transaction, the Stamp Act provides an absolute bar on the use of an unstamped instrument, of which an arbitration agreement is part, for any purpose.

Importantly, by way of the Arbitration (Amendment) Act, 2019, section 11(6A) has been entirely omitted, and an Arbitration Council of India ("**ACI**"), which will be empowered to refer disputes to arbitration, has been proposed to be established. The Constitution Bench did not refer to this amendment, perhaps as it is yet to be notified. In our view, the ratio in this Judgement would, subject to any further amendments by the Legislature, be applicable to appointments made by the ACI.

3. PRACTICAL IMPLICATIONS

Based on its verdict, the Constitution Bench set out two possibilities that could be faced by courts under Section 11 of the Arbitration Act:

- i. **Where the arbitration agreement is unstamped:** the courts would be duty bound to impound the document at the pre-referral stage and would not be empowered to refer the dispute to arbitration.
- ii. **Where the arbitration agreement is said to be insufficiently stamped:** the courts may refer the dispute to arbitration and leave the question of validity of the agreement to be decided by the arbitrator under section 16 of the Arbitration Act.

4. **INDUSLAW VIEW**

In the wake of this Judgement, parties considering arbitration must compulsorily review their agreements, and ensure that stamp duty is paid on the agreements, before approaching courts under Section 11 of the Arbitration Act. This Judgement may be viewed by many as a setback to India's arbitration friendly regime and approach and may be said to dilute the *kompetenz-kompetenz* principle by taking away the arbitrator's power to adjudicate on the validity of arbitration agreements. However, it is also a positive attempt to deter challenges to the validity of the underlying contract at the very outset which often led to delays and to ensure that parties diligently pay stamp duty on agreements.

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