Dispute Resolution Hotline

July 17, 2023

SUPREME COURT CLARIFIES THE SCOPE OF PRE-REFERRAL JURISDICTION UNDER THE ARBITRATION ACT

FACTUAL BACKGROUND

NTPC Ltd. ("**NTPC**") and SPML Infra ("**SPML**") had entered into a contract for a project ("**the Contract**"). Under the Contract, SPML was required to furnish bank guarantees to NTPC. Upon completion of the project, NTPC issued a completion certificate and SPML issued a no-demand certificate. NTPC also released the final payment but withheld the bank guarantees on account of pending liabilities and disputes with respect to other projects. SPML in turn claimed Rs. 72,01,53,899/- from NTPC as liabilities recoverable for actions attributable to NTPC under the Contract.

CHRONOLOGY OF EVENTS

Writ Petition

SPML called upon NTPC to appoint an adjudicator for resolving the pending disputes. Upon failure on the part of NTPC to appoint an adjudicator, SPML filed a Writ Petition with the Delhi High Court ("**High Court**") under Article 226 of the Constitution of India, for the release of the bank guarantees.

Settlement Agreement

Pending a final outcome in the Writ Petition, negotiations between the parties culminated in the execution of a Settlement Agreement ("**the Agreement**"). Under the Agreement, NTPC agreed to release the bank guarantees and SPML undertook to (a) withdraw its pending Writ Petition and (b) not initiate any other proceedings, including arbitration, under the Contract.

Application for the Appointment of Arbitrator

Upon release of the bank guarantees, SPML filed an application before the Delhi High Court for the appointment of an arbitrator to adjudicate upon certain disputes under the Contract ("**the Application**"). The Application was on the basis of the claim that SPML was under economic duress at the time of entering into the Agreement and was coerced into doing so. The Delhi High Court allowed the Application, by observing on a prima facie basis that the claims of SPML might be difficult to establish but still they cannot be held to be "*ex facie untenable, insubstantial or frivolous*".

JUDGMENT

Upon appeal, the Supreme Court ("**the Court**") in its judgment, discussed the jurisprudence on the scope of pre-referral jurisdiction including the jurisprudence prior to the Arbitration and Conciliation (Amendment) Act, 2015 ("**2015 Amendment**") as well as post the 2015 Amendment. The Court examined the facts based on this jurisprudence to pronounce its judgment.

Scope of Pre-referral Jurisdiction Prior to the 2015 Amendment

The Court had categorised the treatment of cases at the pre-referral stage into the following three categories:[i]

(a) cases that will have to be decided by the court itself, such as determination of the existence and validity of the arbitration agreement;

(b) cases that the arbitral tribunal will exclusively decide;

(c) cases that the court may choose to decide, such as determination of whether the parties had concluded the contract / transaction by recording the satisfaction of mutual rights and obligations or by making the final payment. The approach envisaged in the final category is known as the 'accord and satisfaction approach'.[ii]

2015 Amendment: Narrow Scope of Pre-referral Jurisdiction

Pursuant to the recommendations of the 256th Law Commission Report, Section 11(6A)[iii] was inserted by way of the 2015 Amendment, with a view to restrict the jurisdiction of the courts at the pre-referral stage. The enquiry under Section 11(6A) was restricted to the existence of an arbitration agreement and "*nothing more, nothing less.*"[iv] Even so, the pre-2015 Amendment approach of 'accord and satisfaction' was followed by the Court in certain instances.[v] The Court in its interpretation of Section 11(6A) in the landmark case of *Vidya Drolia and Ors. v. Durga Trading Corporation* ("**Vidya Drolia**"),[vi] extended the scope of pre-referral jurisdiction under Section 11(6A), to a prima facie examination of the **existence** and **validity** of the arbitration agreement as well as the **arbitrability** of the subject matter of the dispute.[vii]

Examination of the Facts in the Present Case

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Basis the discussion on the jurisprudence, the Court proposed an "eye of the needle" approach which entails a two-fold inquiry:

(a) The primary inquiry pertains to a thorough examination of the existence and validity of the arbitration agreement;

(b) The secondary inquiry pertains to arbitrability and entails a prima facie review of the facts including an examination of the bona fides of the assertion on arbitrability.

The Court undertook a prima facie examination of the material facts of the present case. It observed that the Agreement had been executed when SPML was protected by an interim order in its Writ Petition. It noted that the Agreement was comprehensive and provided for inter alia, (a) release of the bank guarantees; and (b) a restraint on NTPC from filing contempt proceedings against SPML for letting the bank guarantees expire. The Agreement also recorded that there were no issues pending between the parties. In this context, the Court noted that neither was the Agreement, nor the release of the bank guarantees disputed. Further, it was about two months after the execution of the Agreement and the release of the bank guarantees that SPML issued a letter of repudiation. In light of this, the Court concluded that the letter of repudiation was issued by SPML only to wriggle out of the terms of the Agreement.

Basis the prima facie examination of the facts, the Court found the claims raised by SPML to be an "afterthought" and the allegations of economic duress and coercion, to be lacking bona fide. Therefore, the Court dismissed the application holding the claims and allegations raised by SPML to be "*ex-facie frivolous and untenable*" and "*ex-facie meritless and dishonest.*"

In doing so, the Court observed that supervisory courts cannot act merely mechanically. It is their 'duty' to ensure that parties are not compelled to arbitrate their disputes when the matter is "*demonstrably non-arbitrable.*" Non-performance of this duty would undermine the effectiveness of the arbitration.

The Delhi High Court in this case, following the limited scope of jurisdiction, had referred the disputes on the maintainability of the claims, to the Tribunal. However, the Court in its judgment stated that the Delhi High Court should not have referred the matter to the Tribunal but decided on the bona fides of the claim.

ANALYSIS AND CONCLUSION

The Court, in a series of judgments since the case of *Vidya Drolia* till the present case, appears to have been expanding the scope of review at the pre-referral stage from a mere verification of the existence and validity of the arbitration agreement and arbitrability of the subject matter to also include an examination of the bona fides of the claim. Such an extensive examination is likely to take up extensive time of the already overburdened judiciary. On account of such precedents, it might become difficult for courts to restrict their jurisdiction to merely checking the existence and validity of the arbitration agreement, and the arbitrability of the subject matter.

Further, in light of the current development in *N.N. Global Mercantile Pvt. Ltd. v. Indo Unique Flame*[viii] the pre-referral jurisdiction of courts has already been expanded to taking a prima facie view on the sufficiency of stamping as well. Parties intending to delay or avoid an arbitration may use this position to cater to their commercial interests by raising multiple issues relating to the bona fides of the claim at the pre-referral stage itself. Hence, the widening scope of pre-referral jurisdiction could potentially be used in the form of a dilatory tactic thereby reducing the efficiency of the arbitration process.

Notably, Section 11(6A) was omitted by the Arbitration and Conciliation (Amendment) Act, 2019 ("**2019 Amendment**"). However, the omission is yet to be notified. It is noteworthy that the 2019 Amendment lacks specific reasons for the omission of Section 11(6A). The focus of the 2019 Amendment appears to be on institutional arbitration. However, the question that then arises is whether arbitral institutions should also have to undertake the examination described above, at the pre-referral stage.

Widening the jurisdiction at the pre-referral stage would defeat the concept of a time bound and expeditious arbitration process, as an expansive examination might take much longer and may even result in an unfavourable outcome with an arbitrator not being appointed, as in the present case.

– Shruti Dhonde, Arjun Gupta & Sahil Kanuga

You can direct your queries or comments to the authors.

[i] National Insurance Co. Ltd. v. Boghara Polyfab (P) Ltd., (2009) 1 SCC 267.

[ii] New Indian Assurance co. Ltd. v. Genus Power Infrastructure Ltd., (2015) 2 SCC 424.

[iii] "(6-A) The Supreme Court or, as the case may be, the High Court, while considering any application under sub-section (4) or sub-section (5) or sub-section (6), shall, notwithstanding any judgment, decree or order of any court, confine to the examination of the existence of an arbitration agreement."

[iv] Duro Felguera v. Gangavaram Port, (2017) 9 SCC 729.

[v] United India Insurance Co. Ltd. v. Antique Art Exports Pvt. Ltd., (2019) 5 SCC 362.

[vi] (2021) 2 SCC 1.

[vii] Vidya Drolia and Ors. v.Durga Trading Corporation, (2021) 2 SCC 1.

[viii] 2023 SCC OnLine SC 495.