Supreme Court on the enforceability of an unstamped or insufficiently stamped arbitration agreement

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The Supreme Court has expounded upon the legal validity of an unstamped or insufficiently stamped arbitration agreement at the stage of reference of disputes under Section 11 of the Arbitration and Conciliation Act, 1996. This update briefly discusses the varying judicial opinions that led to this issue being referred to a Constitution Bench of the Supreme Court and analyses the key points of the Supreme Court's clarificatory ruling.

1 Introduction

A five-judge bench of the Supreme Court of India, in its judgement dated 25 April 2023, in *M/s N.N. Global Mercantile Private Limited v M/s Indo Unique Flame Ltd. & Ors.* (**N.N. Global 2023**), has held that an arbitration agreement in an unstamped or insufficiently stamped agreement is unenforceable and non-existent in law until such agreement is validated by paying requisite stamp duty in accordance with the procedure laid down under the Indian Stamp Act, 1899 (**Stamp Act**).

2 Background

The need for reference of this question to a five-judge bench arose due to a fracture of opinions in several previous decisions of the Supreme Court in relation to the implications of an unstamped or insufficiently stamped agreement including, more specifically, on the validity and existence of the arbitration agreement contained in such an agreement.

This issue first came up for consideration before a two-judge bench of the Supreme Court in *SMS Tea Estate v Chandmari Tea Company* (2011) (**SMS Tea**), wherein it was held that when an unstamped or insufficiently stamped agreement is presented before the court in an application under Section 11 of the Arbitration and Conciliation Act, 1996 (**Arbitration Act**), the court must first impound the agreement and only upon the payment of requisite stamp duty, it may proceed with the appointment of an arbitral tribunal.

Thereafter, Section 11(6A) was inserted in the Arbitration Act through an amendment in 2015. Section 11(6A) sought to limit the scope of examination of a court at the pre-arbitration reference stage only to the *'existence of an arbitration agreement'*. Another two-judge bench of the Supreme Court in *Garware Wall Ropes v Coastal Marine Constructions & Engineering Ltd.* (2019) (**Garware**) endorsed the view taken in *SMS Tea* and held that the findings in *SMS Tea* will continue to be applicable even post-insertion of Section 11(6A) as an arbitration agreement that is not enforceable does not *'exist'* in law.

A three-judge bench of the Supreme Court in *Vidya Drolia v Durga Trading Corpn.* (2021) affirmed the decisions in *SMS Tea* and *Garware* and held that *'existence'* and *'validity'* are interrelated concepts such that an arbitration agreement exists only when it is legal and valid. However, another three-judge bench in *N.N. Global Mercantile Private Limited v Indo Unique Flame Limited and others* (**NN Global 2021**), adopted a divergent view from these decisions and held that there is no legal impediment as to the enforceability of unstamped or insufficiently stamped arbitration agreement pending payment of stamp duty and it is only the adjudication of the rights under such agreements that cannot be proceeded with.

Given this variance in opinions, the three-judge bench in *NN Global 2021* referred the following question for consideration of a larger five-judge bench of the Supreme Court:

"*Whether the statutory bar contained in Section 35 of the Stamp Act 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, as being non-existent, pending payment of stamp duty on the substantive contract/instrument?*"

3 Supreme Court's ruling

At the outset, the Supreme Court held that its three-judge bench in *N.N. Global 2021* erroneously concluded that an arbitration agreement is not an instrument chargeable to payment of stamp duty. It held that an arbitration agreement unambiguously falls under the category of an '*agreement or memorandum of agreement*' that subjects all agreements that are not otherwise specifically provided for in the Stamp Act to payment of stamp duty.

Thereafter, the Supreme Court held that an unstamped or insufficiently stamped agreement is not enforceable as long as it remains unstamped. As regards the existence of such an unstamped or insufficiently stamped agreement, the Supreme Court held that as per the provisions of the Indian Contract Act, 1872, only an agreement that is enforceable in law attains the status of a '*contract*'. As such, an unstamped or insufficiently stamped agreement does not exist in law and can be validated only upon the payment of the requisite stamp duty.

It was also held that it is incumbent upon any authority that encounters an unstamped or insufficiently stamped agreement to impound it as per the provisions of the Stamp Act. This would entail that the unstamped or insufficiently stamped agreement will not be enforceable until the receipt of an endorsement certificate recording the payment of the stamp duty along with the applicable penalty on the instrument. The Supreme Court elucidated that such stringent provisions on stamping have been enacted to ensure compliance with a fiscal measure such as the Stamp Act and to avoid any loss in revenue for the State. For these reasons, the Supreme Court also held that the issue of non-payment of the applicable stamp duty, though curable, cannot be trivialised as a mere '*technicality*'.

The Supreme Court then ventured into the most pertinent question of the stage at which such impounding ought to occur. It held that the payment of the requisite stamp duty can only happen "*under the watchful gaze of the Court*", i.e., the high court or the Supreme Court, as the case may be, that is then seized of the proceeding for the appointment of an arbitral tribunal. The Supreme Court was also of the view that such an approach will also not be inconsistent with the provisions of the Arbitration Act that limit the scope of examination of the court at the stage of the appointment of an arbitral tribunal to the mere existence of an arbitration agreement. This conclusion was in view of its finding that an unstamped or insufficiently stamped arbitration agreement cannot even be said to exist in law at all.

However, the Supreme Court carved out a limited exception to this finding insofar as it held that in cases where an objection against the sufficiency of the stamp duty paid *prima facie* appears wholly without foundation, such issue may be left to the conclusive determination of the arbitral tribunal upon its appointment.

Lastly, the Supreme Court clarified that the aforesaid compliance with the provisions of the Stamp Act will have to be ensured even in cases where a certified copy of an arbitration agreement (instead of the original arbitration agreement) is produced before the court for seeking appointment of an arbitral tribunal. Much like its original, such certified copy of the arbitration agreement will also become enforceable only if it discloses the factum of the payment of the applicable stamp duty on its original.

4 Observations

The ruling of the five-judge bench of the Supreme Court is expected to have far-reaching consequences on parties (corporate or otherwise) intending to initiate arbitrations under unstamped or insufficiently stamped agreements. Judgements of Indian courts are applicable retrospectively unless expressly made prospective. This ruling is, therefore, likely to apply even to agreements executed in the past, pending arbitrations and ongoing arbitration-related court proceedings. While the Supreme Court has now clarified the issue of the enforceability of the unstamped or insufficiently stamped arbitration agreements, several issues continue to remain in the grey, including the applicability of this decision to foreign arbitrations, grant of interim reliefs, validity and enforceability of arbitral awards, to name a few.
