

# Dispute Resolution Hotline

November 21, 2008

## VALIDITY OF ARBITRATION AGREEMENT: WHO DECIDES?

The Hon'ble Supreme Court of India ("Court") in a recent decision in the matter of Ludhiana Improvement Trust ("Trust") & Anr. Vs. Today Homes and Infrastructure (Pvt.) Limited ("Today Homes") in Civil Appeal No. 6104 of 2008 decided on October 14, 2008 examined the powers of appointment of arbitrators by the Chief Justice of Supreme / High court, in the backdrop of section 11 (6)<sup>i</sup>, read with the competence of arbitral tribunal to rule on its jurisdiction, as envisaged under section 16<sup>ii</sup> of the Arbitration and Conciliation Act, 1996. ("Act"). On the issue of the powers conferred under section 11 (6) of the Act, the Court relied on its constitutional bench decision in the case of **S.B.P. & Co. v/s Patel Engineering Ltd.**<sup>iii</sup> ("Patel Engineering") reinforcing that such power is judicial and not an administrative power, overruling the case of Konkan Railway Corporation v. Rani Construction and Anr. ("Konkan Railway"). In this important decision, the Court remanded the matter to the Punjab & Haryana High Court, whose order was appealed before the Court. The Court emphasized that Chief Justice under section 11(6) in the exercise of his judicial power, is expected to adjudicate on contentious issues such as existence of valid arbitration agreement.

## BACKGROUND & SUBMISSIONS:

The Trust executed a Letter of Intent pursuant to a contract ("Contract") with Today Homes for the development of City Center in the city of Ludhiana (State of Punjab & Haryana.) The said Contract contained an arbitration clause. During the continuance of the Contract, certain disputes arose, pursuant to which Today Homes invoked the arbitration agreement ("Arbitration Agreement") in the Contract. On failure of the Trust to appoint an arbitrator as provided under the Arbitration Agreement, an application was made to the Chief Justice of Punjab and Haryana High Court, under section 11(6) of the Act for appointment of an arbitrator. On behalf of the Trust, one of the contentions raised was that as the Contract was induced by fraud and various irregularities the same was rendered void. Consequently, the Arbitration Agreement which formed a part of the said Contract was also null and void and therefore the disputes under the Contract could not be referred to arbitration.. After consideration of the submissions and mainly relying on the decision in the Konkan Railway case, the High Court appointed an arbitrator and referred the disputes including the validity of the Contract before the arbitrator.. Accordingly, it was for the arbitrator and not the Chief Justice to decide the question of jurisdiction as provided under section 16 of the Act.

Aggrieved by the decision of the Punjab & Haryana High Court, Today Homes preferred an appeal to the Court. On behalf of the Trust it was mainly argued that since the Contract was fraudulently obtained, even the Arbitration Agreement contained therein was void and unenforceable. On the other hand, Today Homes mainly contended that the Contract and Arbitration Agreement could not be equated as both were for different purposes and even if the Contract was void, that would not affect the Arbitration Agreement, on the basis of severability of the Arbitration Agreement from the Contract as stipulated under section 16 of the Act.

## JUDGMENT:

The Court after hearing the submissions categorically observed that the decision in the case of Patel Engineering was not considered by the High Court. The Court inter alia held that the High Court, unfortunately relying on the earlier constitution bench decision in the Konkan Railway case, left it to the arbitrator to decide the issues including that of jurisdiction and validity of the arbitration agreement under section 16 of the Act. This was contrary to the seven judge bench decision of the Court in Patel Engineering case, which overruled the decision in the Konkan Railway case. Accordingly, the High Court ought to have exercised its jurisdiction under section 11(6) in deciding the issues inter alia that of validity of the Arbitration Agreement. The rationale being that the powers exercised by the Chief Justice of Supreme /High Court under section 11(6) were judicial and not an administrative powers as held in Patel Engineering.

The Court in that case had categorically held that the Chief Justice or the designated judge will have the right to decide the preliminary aspects as: (i) right to rule on its own jurisdiction and to entertain such request; (ii) the existence or otherwise of a live claim;(iii) the existence of the condition for the exercise of his power and on the qualifications of the arbitrator or arbitrators.

In view thereof, the Court set aside the order of the Chief Justice of the Punjab & Haryana High Court and remanded the matter back for a fresh decision considering the judgment in case of Patel Engineering.

## ANALYSIS AND IMPLICATIONS:

The said decision echoes and re affirms the principles laid down by the Court in the constitutional bench judgment in the Patel Engineering case. In the case discussed, the Trust had also raised the issue of invalidity of the Arbitration Agreement on the ground that the Contract was vitiated by fraud and hence invalid. The Court has not decided on this issue specifically. However, the Court relying on the Patel Engineering case seem to have reaffirmed the crucial distinction between an administrative and judicial power. While exercising a judicial power, unlike a mere administrative function, the Chief Justice of Supreme / High Court would be expected to adjudicate on contentious issues such as the existence and validity of an arbitration agreement and whether the dispute is capable of being

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Section 16 of the Act incorporates the important doctrine of *Kompetenz – Kompetenz or competence de la compétence* by which the arbitral tribunal is primarily competent to determine the issue of its own jurisdiction including objections raised with regard to the existence or validity of the arbitration agreement, subject to of course final review of a competent court. This judgment is crucial as it indicates a shift in the realm of power exercised by the arbitral tribunal under section 16 to the court, while exercising its judicial power of appointment of arbitrator under section 11(6) of the Act. This to an extent dilutes the applicability of the Section 16 of the Act, as also observed by the Hon'ble Judge in the dissenting judgment in Patel Engineering case.

Finally, we believe that the two ends of minimizing judicial intervention in arbitration and reducing delays in the process which the Act seek to promulgate, are once again put to test in the judgment discussed.

Source: **Ludhiana Improvement Trust ("Trust") & Anr. Vs. Today Homes and Infrastructure (Pvt.) Limited ("Today Homes")**

- **Advait Sethna & Vyapak Desai**

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#### i. Section 11(6): Appointment of Arbitrators:

Where, under an appointment procedure agreed upon by the parties,—

- (a) a party fails to act as required under that procedure; or
- (b) the parties, or the two appointed arbitrators, fail to reach an agreement expected of them under that procedure; or
- (c) a person, including an institution, fails to perform any function entrusted to him or it under that procedure,

a party may request the Chief Justice or any person or institution designated by him to take the necessary measure, unless the agreement on the appointment procedure provides other means for securing the appointment.

#### ii. Section 16: Competence of arbitral tribunal to rule on its jurisdiction:

(1) The arbitral Tribunal may rule on its own jurisdiction, including ruling on any objections with respect to the existence or validity of the arbitration agreement, and for that purpose,—

- (a) an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract; and
- (b) a decision by the arbitral Tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause.

(2) A plea that the arbitral Tribunal does not have jurisdiction shall be raised not later than the submission of the statement of defence; however, a party shall not be precluded from raising such a plea merely because that he has appointed, or participated in the appointment of, an arbitrator.

(3) A plea that the arbitral Tribunal is exceeding the scope of its authority shall be raised as soon as the matter alleged to be beyond the scope of its authority is raised during the arbitral proceedings.

(4) The arbitral Tribunal may, in either of the cases referred to in sub-section (2) or sub-section (3), admit a later plea if it considers the delay justified.

(5) The arbitral Tribunal shall decide on a plea referred to in sub-section (2) or sub-section (3) and, where the arbitral Tribunal takes a decision rejecting the plea, continue with the arbitral proceedings and make an arbitral award.

(6) A party aggrieved by such an arbitral award may make an application for setting aside such an arbitral award in accordance with section 34.

iii. AIR2006SC450.

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