ROLE OF COURT IN PRIMA FACIE DECIDING ON THE VALIDITY OF ARBITRATIONAL AGREEMENT UNDER SECTION 8

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ABSTRACT

India is a highly populated country with billions of people. Our legal system of resolving disputes has resulted in pending cases, which rightly justify the maxim “Justice delayed is the Justice denied”. The Judicial System of India is based on evidence and facts. So unfortunately, the legal proceedings in a Court of law get stretched down to years, consuming a lot of money and time which ultimately leads to disruption of justice.

Alternate dispute resolution is an emerging field in the Indian society. The word ‘alternative’ means another choice or option something which is an alternative to Court procedures or something which can be operated beyond the court. The main aim of this new mechanism of dispute resolution is a voluntary settlement between parties outside the court. The primary objective of the system is avoidance of expense and delay in accessing Justice. It avoids rigidity and seems to be more flexible which is inevitable in the litigation process. Hence, ADR is not just an alternative way to maintain social peace in the society but can also be termed as a complementing approach for our judicial system.

The Supreme Court's recent decision in Vidya Drolia v. Durga Trading Corporation ('Vidya Drolia') has finally resolved a number of key issues that had been causing confusion in Indian arbitration law. It has settled and corrected a number of difficulties relating to India's domestic arbitration system, notably the long-running debate about the extent of court intervention in the pre-arbitral stage of an arbitration agreement. The scope of court intervention in this pre-arbitral stage has been considerably reduced by the court.

The present article will address the above-mentioned legal issues and throw light on the legal position of the scope of inquiry of judicial intervention in a pre-arbitral stage. It will look at the transition in the approach of the legislature and courts while analyzing the recent amendments and the judicial pronouncements which connoted such a shift.

Introduction

Section 8 of the Act allows a judicial body to refer parties to arbitration where a valid arbitration agreement already exists, thereby honoring the parties' (pre-dispute) agreement. Similarly, Section 11 of the Act permits the judicial authority to assist parties in appointing arbitrators prior to the initiation of arbitration proceedings, provided that a valid arbitration agreement exists. Because the aforementioned events occur prior to the formation of an arbitral tribunal, this stage is referred to as the "Pre-Arbitral/ Referral Stage."

Furthermore, both the above-mentioned situations arising under Sections 8 and 11 have a similarity in that both the applications are subject to judicial scrutiny in relation to their existence regarding the arbitration agreement's legality The grey area in the arbitration realm is this act of inspection by judicial authority. Since the courts have this power of examination, the question of what should be the extent of judicial intervention at this stage and where the line should be drawn has become very important.

Section 8 of Arbitration and Conciliation Act, 1996

"Power to refer parties to arbitration where there is an arbitration agreement. —

(1) A judicial authority before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so applies not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration.

(2) The application referred to in sub-section (1) shall not be entertained unless it is accompanied by the original arbitration agreement or a duly certified copy thereof.

(3) Notwithstanding that an application has been made under sub-section (1) and that the issue is pending before the judicial authority, an arbitration may be commenced or continued, and an arbitral award made."[1]

Section 11(6A) of Arbitration and Conciliation Act, 1996

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

(a) a party fails to act as required under that procedure; or

[1] https://legislative.gov.in/sites/default/files/A1996-26.pdf, Last visited on 24/02/2022, 10:00 AM

(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."[2]

Defeating the objectives of the Act: prior to the 2015 Amendment

The legislature's goal in enacting the arbitration and conciliation act of 1996 was to:

(1) reduce judicial intervention in arbitration proceedings.

(2) Make India's arbitration environment more responsive to contemporary demands; and

(3) expedite case resolution, easing the burden on the overburdened judiciary.

In the case of Boghara Polyfab Pvt. Ltd. v. National Insurance Company Ltd.,[3] the Apex Court relied on SBP & Co. v. Patel Engineering Ltd.[4] to categorize the issues that can or cannot be decided by the concerned court when appointing the arbitrator under Section 11 prior to the 2015 Amendment Act.

Furthermore, the aforementioned cases not only granted judicial bodies the jurisdiction to determine on the existence of an arbitration agreement, but they also gave them the power to decide on the preliminary issues involved. As a result, the Judicial's function as a 'facilitator' has shifted, resulting in increasing court interference in the arbitral process, and the Court's increased engagement essentially means slower case resolution. Furthermore, the decision to give courts the authority to decide on primary or jurisdictional problems goes against Section 16 of the Act, which recognizes the Kompetenz-Kompetenz principle.

Furthermore, the Supreme Court declared in Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd[5]. and A. Ayyasamy v. A. Paramasivam and Others,[6] while addressing Section 8 of the Act, that held that a Court at the pre-arbitral stage itself should decide not merely the existence but

[2] https://legislative.gov.in/sites/default/files/A1996-26.pdf, Last visited on 24/02/2022, 10:02 AM
[3] 2007 (4) ARBLR 533 Bom, 2007 (4) BomCR 684
[4] 2007 (4) ARBLR 533 Bom, 2007 (4) BomCR 684
[5] (2011) 5 SCC 532
[6] CIVIL APPEAL NOS. 8245-8246 OF 2016

also the validity of the arbitration agreement (including the arbitrability of the dispute), thereby overlooking the principle of Section 16 again.

Evidently, in the above-mentioned decisions, it can be seen that the scope of Sections 8 and 11 was widened by the court which has gone against the intention of the legislature, therefore thwarting the spirit of the Act.

The 2015 Amendment: an attempt to restrict the scope of judicial intervention

The Law Commission of India suggested revisions to Sections 8 of the Arbitration Act in its 246th report, with the goal of limiting judicial interference at the pre-arbitral stage and stating that courts only need to decide whether an arbitration agreement exists prima facie. As a result, the court is required to refer the parties to arbitration, with the arbitral tribunal making the final decision on the existence and legality of the arbitration agreement under Section 16. On the other hand, if the judicial authority finds that the arbitration agreement does not exist based on its prima facie judgement, the judicial authority can make the final decision, saving the arbitral tribunal time.

The Prima facie test was enacted as a result of the 246th Law Commission report through the 2015 Amendment Act, which was also intended to neutralize the effect of Booz Allen and Ayyasamy.

The term "prima facie" was not put into Section 11 (6A) as a result of the Law Commission's recommendation. As a result, the prima facie test's applicability was confined to petitions filed under Section 8. As a result, the legislators created considerably more havoc by leaving an open question about the scope of Section 11 examinations. It also shifted the debate significantly by posing the fundamental question of whether there is parity in approach when dealing with the scope of investigation under Sections 8 and 11? (As both were concerned with court action during the pre-arbitral stage.)

The aftermath of the 2015 Amendment

Despite the 2015 Amendment, the Supreme Court has been split between opposing viewpoints on the standards and breadth of scrutiny to be applied when dealing with pre-arbitral issues, such as an application for appointment of an arbitrator or referring parties to arbitration. (See Sections 8 and 11 for more information.)

In Duro Felguera v. Gangavaram Port Limited ("Duro Felguera"),[7] it was declared at the outset that the courts were simply had to look at the existence of an arbitration agreement - "nothing more, nothing less." In this case, the court used the literal interpretation rule to limit the scope of the inquiry to the 'presence' of an arbitration agreement, as well as establishing particular criteria for determining the same. The court held:

"According to a reading of Section 11(6-A), the legislature's objective is crystal clear: the court should and must only look into one issue – the presence of an arbitration agreement." The second question is what considerations go into deciding whether or not there is an arbitration agreement. The remedy is simple: look to see if the agreement contains a section that provides for arbitration in the event of a dispute between the parties."

Nevertheless, later in March 2019, the court in United India Insurance v. Hyundai Engg. & Construction Co. Ltd.[8], while relying on Duro Felguera came up with different reasoning and held that the prerequisite for invoking arbitration was not met which rendered the arbitration clause ineffective and incapable of being enforced. On one side, many consider this approach to be in contravention with that in Duro Felguera, while others believe that it followed Duro's verdict which included inquiry of 'scope' as a factor to determine existence. The court ruled:

"Suffice it to say that appointment of arbitrator is a judicial power and is not merely an administrative function leaving some degree of judicial intervention; when it comes to the question to examine the existence of a prima facie arbitration agreement, it is always necessary to ensure that the dispute resolution process does not become unnecessarily protracted."

Similarly, in Garware Wall Ropes Ltd. v. Coastal Marine Constructions & Engg. Ltd,[9] while addressing a matter under Section 11 went on to determine whether the arbitration agreement was duly stamped i.e., it goes on to ascertain the validity of an arbitration agreement instead of its 'existence.' Concerning this, the court gave the reasoning that----- "determination of existence included 'de jure' existence of the agreement." In essence, the court appeared to have lost track and seems to be confused between 'existence' of an agreement and its validity. As a consequence, this added another substantial question (Whether the "existence" or rather

[7] (2017) 9 SCC 729
[8] Civil Appel No. 10386 of 2018
[9] CIVIL APPEAL NO. 3631 OF 2019

"validity" of an arbitration agreement is to be examined) to the contentious debate of Scope of examination at the pre-arbitral stage.

United India Insurance was later overruled by Mayavati Trading Pvt Ltd v. Pradyuat Deb Burman[10], wherein the Supreme Court stated that courts were not supposed to go further than determining the existence of the arbitration agreement. Also, it reaffirmed that "Section 11(6-A) is confined to the examination of the existence of an arbitration agreement and is to be understood in the narrow sense as has been laid down in the judgment of Duro Felguera." Nevertheless, the court missed addressing the issue of "scope" of such examination here as well.

Circumstances emerged in the aftermath of the 2015 amendment

The Supreme Court's interpretation of Section 11 of the Act was erratic. As a result, the 2015 Amendment failed to achieve its objectives of minimal judicial interference and making India an arbitration-friendly jurisdiction, as the courts appear to have disregarded the principle of Kompetenz-Kompetenz, thus overlooking the tribunal authority to rule on its own jurisdiction under Sec 16.

Repealing of Section 11 (6-A): 2019 Amendment Act

The Indian Legislature enacted the 2019 Amendment Act to address and correct the faults in order to improve India's status as an arbitration-friendly country. Subsections (6-A) and (7) have been repealed as a result of the revision. Because the modification aimed to improve institutional arbitration in India, arbitrators will be appointed by Arbitral Institutions designated by the Apex Court and High Courts under the revised Section 11(6) of the Arbitration and Conciliation Act.

Vidya Drolia Judgment settles the controversy: Parity between Section 8 and 11

Despite the differences in terminology, the Supreme Court concluded in the Vidya Drolia case that the scope of review under Section 8 and Section 11 is similar, recognizing the necessity for parity between the two clauses. As a result, it ruled that the 'prima facie' requirement applied equally to the authority of judicial review under Section 11, so incorporating the 'mandate of

[10] 2019 (8) SCC 714

a valid arbitration agreement' in Section 8 into the mandate of Section 11, i.e. "the presence of an arbitration agreement."

Validity of the Section

Furthermore, the Supreme Court reiterated that the existence and validity of an arbitration agreement are essentially intertwined, with an invalid arbitration agreement not being capable of existing, so that a 'prima facie' judicial review of existence would inevitably entail a determination of its validity.

To elaborate, Section 8 of the Act mandates that a court authority refer the parties to arbitration unless it finds that there is no genuine arbitration agreement prima facie. Section 11 limits the court's powers to determining the existence of an arbitration agreement, according to a plain interpretation (of the now-defunct sub-section 6A). The court, on the other hand, holds that a contract has no meaning unless it is legally enforceable, and therefore an arbitration agreement that is not legitimate or legally enforceable is not a contract at all. As a result, even under Section 11, the court has the authority to assess the arbitration agreement's legitimacy prima facie.

Existential crises of Section 11 (6-A) and matters of arbitrability

The court agreed with Mayavati Trading's interpretation of Section 11 (6-A), which stated that "Section 11(6-A) is limited to the investigation of the 'presence' of an arbitration agreement and is to be interpreted in the restricted meaning." Furthermore, the court stated that the subsequent deletion of Subsection 6A had no bearing on the court's decision.

Also, concerning the issues of arbitrability as faced by a court at the Referral Stage, the court has accepted and upheld the principles of the 3 Stages as laid down in the case of National Insurance Co. Ltd. v. Boghara Polyfab. The court also acknowledges that in determining these concerns, "the referring court must strike a balance between the enforcement of arbitration agreements and the protection of parties from being pushed into arbitration where disputes are manifestly non-arbitrable."

Test of the Prima Facie Rule

The Supreme Court puts an end to the kerfuffle by upholding the 246th Law Commission Report and reiterating that courts must only decide whether an arbitration agreement exists

"prima facie." As a result, courts must submit the parties to arbitration, with the arbitral tribunal making the final decision on the existence and legality of the arbitration agreement.

This was specified to indicate a preliminary examination purely for the purpose of "weeding out ex-facie, non-existent, and illegitimate arbitration agreements, as well as non-arbitrable cases." A prima facie case, according to the court, is related to the development of first presumption rather than an evidence threshold. An application would be made only if the court is confident that there is no legitimate arbitration agreement in place or that the disputes are not arbitrable under Section 8 be rejected.

This conclusion must be 'preliminary and summary' in character, based on the materials submitted, rather than a mini-trial. In summary, unless there are substantial and compelling reasons not to, a referring court would typically require parties to abide by the arbitration agreement. Where problems about the contract's creation, existence, or legality, as well as questions about non-arbitrability, are complex and entwined with issues of fact, and cannot be resolved on a prima facie basis, the court has clarified that they must be adjudicated by an arbitral tribunal.

It also specifies that where there are jurisdictional concerns or when a multi-party arbitration presents complicated factual matters, the arbitral panel must handle them. In the case of Uttrakhand Kalyan Nigam v. Northern Coal Field Ltd.,[11] it was also decided that the tribunal will handle all other preliminary objections/questions.

The Supreme Court upheld the above-mentioned rule in Pravin Electricals (P) Ltd. v. Galaxy Infra and Engg. (P) Ltd.,[12] where a number of factual and evidentiary issues necessitated a more thorough examination, setting aside the Delhi HC decision and stating that the arbitration agreement exists, thus confirming the appointment of an arbitrator. In a nutshell, the Court's rule is when in doubt, do refer’.

Conclusion

The recent spate of Section 8 rulings has been well-considered and promising. With the rapid and numerous developments in both the arbitration and IBC regimes, problems about the interplay of these issues, as well as what and how much can be considered by a Court at the

[11] Special Leave Petition (C) No. 11476 of 2018
[12] CIVIL APPEAL NO. 825 OF 2021

threshold stage, are expected to arise. The general trend has been to regard Section 8 applications as peremptory and sacred, leaving the bulk of the questions to be decided by the arbitral tribunal, including (in the case of Pravin Electricals) the existence of the arbitration agreement. Because problems of jurisdiction and arbitrability should be left to the Tribunals, this method is consistent with international standards. This strategy has another advantage aside from minimizing backlog. If, after reviewing all evidence, a Tribunal determines that an arbitration agreement does not exist, that is the end of the dispute, and no prejudice is given to the party denying the existence of the arbitration agreement. Such an investigation would necessitate the evaluation of (often difficult) factual problems, and a Court at this stage is simply not the appropriate venue for it. As a result, even the side claiming the existence of an arbitration agreement will be treated fairly. The Supreme Court in Vidya Drolia left the severity of the summary and prima facie review to the referring court's discretion, keeping in mind that the legislature's ultimate goal was to protect the public interest and to make referring court act as a 'facilitator' and to mere assist the arbitration procedure and not usurp the jurisdiction of the arbitral tribunal in that regard.

However, it would not be wrong to predict that the lack of clarity will persist even after the landmark Vidya Drolia decision and the 2019 Amendment Act. It is suggested that there is still room for debate because certain important concerns remain unaddressed by the Legislature or the Judiciary, such as what should the arbitral institutions examine now while considering an application for appointment of an arbitrator. Only time will tell if this is true.