CONTRACTUAL SANCTITY OR PROCEDURAL ABSOLUTISM? A CRITICAL ANALYSIS OF DAMAGES FOR BREACH OF ARBITRATION AGREEMENTS

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ABSTRACT

Recognition of damages as a remedy for breach of arbitration agreements is a big development in the evolving arbitration jurisprudence. Courts have increasingly treated the initiation of court proceedings contrary to an arbitration clause as a contractual wrong, reinforcing party autonomy and discouraging parallel litigation. However, this approach raises a fundamental question, which is- whether every recourse to courts in the face of an arbitration agreement be characterized as a breach? In matters concerning the validity, scope, and arbitrability of disputes, judicial restraint is usually advised. In this context, imposing damages for all unsuccessful court challenges risks conflating bona fide jurisdictional objections with abusive litigation. This paper examines the doctrinal boundary between legitimate judicial recourse and contractual breach, arguing that liability should arise only in cases of bad faith, vexatious conduct, or procedural abuse.

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I. INTRODUCTION

Arbitration agreements represent a conscious allocation of adjudicatory authority by contracting parties, thus underscoring the foundational principle of party autonomy in dispute resolution. It has been sufficiently emphasised by judicial bodies that agreements must be enforced rigorously in order to preserve commercial certainty and minimize judicial interference.[3] Recent developments in common law jurisprudence have recognized that the initiation of court proceedings in violation of an arbitration clause may constitute a breach of contract, entitling the aggrieved party to claim damages for losses incurred in resisting such proceedings.[4] This emerging remedy complements traditional mechanisms such as anti-suit injunctions and reinforces the negative obligation inherent in arbitration agreements not to pursue litigation elsewhere.

From a superficial perusal, the contractual characterisation of such conduct seems basic. Arbitration agreements are enforceable contracts, and under the foundational principles of contract law, a party that acts contrary to its contractual commitments must compensate the other side for foreseeable losses arising from the breach.[5] The binding nature of arbitration agreements is recognised by way of Section 73 and 74 of the Indian Contract Act, 1872, which provides for compensation for breach.[6] The pro-arbitration nature of the Arbitration and Conciliation Act, 1996 ("Act") further strengthens the expectation that parties will adhere to their agreement to arbitrate.[7]

However, the increasing recognition of damages for breach gives rise to a more layered doctrinal question that has received limited scholarly attention. Modern arbitration frameworks do not exclude judicial involvement altogether. The Act expressly contemplates court intervention at multiple stages, including the determination of the existence of an arbitration agreement, appointment of arbitrators, review of jurisdictional objections, and setting aside of arbitral awards.[8] It has been repeatedly affirmed that courts retain a limited but essential supervisory role, particularly in matters relating to arbitrability, validity, and jurisdiction.[9] In

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[3] The Angelic Grace, [1995] 1 Lloyd's Rep. 87 (CA).
[4] Union of India v. McDonnell Douglas Corp., (1993) 2 Lloyd's Rep. 48.
[5] Hadley v. Baxendale, (1854) 156 Eng. Rep. 145 (Exch.).
[6] Indian Contract Act,1872, §§ 73–74, No. 9, Acts of Parliament, 1872 (India).
[7] Arbitration and Conciliation Act 1996, § 5, No. 26, Acts of Parliament, 1996 (India).
[8] Id. §§ 8, 11, 16, 34.
[9] Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd., (2011) 5 SCC 532; Vidya Drolia v. Durga Trading Corp., (2021) 2 SCC 1; Mayavati Trading Pvt. Ltd. v. Pradyuat Deb Burman, (2019) 8 SCC 714.

such circumstances, recourse to courts may represent the exercise of a statutory right rather than a repudiation of contractual obligations.

The difficulty arises when unsuccessful judicial challenges are subsequently characterized as contractual breaches. An unqualified approach risks conflating bona fide jurisdictional objections with vexatious litigation. This may create a chilling effect and thus discourage parties from raising legitimate concerns regarding the validity or scope of the arbitration agreement and thereby undermining the consensual foundation of arbitration.[10] At the same time, an overly permissive approach would weaken the enforceability of arbitration clauses and encourage parallel proceedings.

This paper examines the doctrinal boundary between legitimate judicial recourse and contractual breach in the context of claims for damages arising from court proceedings instituted contrary to arbitration agreements. It argues that liability should not follow merely because a court ultimately rejects a party's challenge. Instead, damages ought to be confined to cases involving bad faith, abuse of process, or manifestly frivolous conduct, thereby preserving the balance between arbitral autonomy and judicial supervision embedded within the statutory framework.

II. THE CONTRACTUAL BASIS OF DAMAGES FOR BREACH OF ARBITRATION AGREEMENTS

The recognition of damages for breach of arbitration agreements is rooted in the contractual nature of such agreements. An arbitration clause is not merely a procedural arrangement but a binding contractual obligation through which parties agree to submit disputes to a private forum and, correspondingly, refrain from pursuing remedies before statutory courts.[11] Both a positive obligation to arbitrate and a negative obligation to refrain from litigation are imposed by this dual nature. When a party files a lawsuit outside of the designated arbitral forum, the violation of this negative covenant serves as the theoretical basis for claims for damages.

A party who breaches a contract is obligated to reimburse the other party for losses that result naturally from the breach or that were reasonably foreseeable at the time of the contract,

[10] Gary B. Born, International Commercial Arbitration 1125–30 (3d ed. 2021).
[11] Gary B. Born, International Commercial Arbitration 1045–50 (3d ed. 2021).

according to general rules of contract law.[12] The other party frequently has to pay high legal fees when attempting to obtain dismissal, a stay of proceedings, or anti-suit relief when litigation is started in violation of an arbitration agreement. These costs could be seen as the inevitable and predictable result of breaking the arbitration clause in the contract.[13]In this sense, the claim for damages reflects orthodox contractual reasoning rather than a novel innovation.

English courts have played a significant role in articulating this approach. In *The Angelic Grace*, the Court of Appeal emphasized that arbitration agreements should ordinarily be enforced as a matter of course, underscoring the binding nature of the parties' promise to arbitrate.[14] Subsequent decisions have accepted that losses resulting from foreign litigation instituted in breach of such agreements may be recoverable as contractual damages.[15] The cardinal rationale is that parties select arbitration specifically to avoid the cost, time, and uncertainty of going to court; any departure from this impedes the two parties' ability to conduct business.

Sections 73 and 74 of the Indian Contract Act, 1872 provide the statutory basis for compensation arising from contractual breach, which is highlighted to underscore the recognition given to the binding nature of arbitral agreements.[16] The Act further reinforces the binding nature of arbitration agreements by limiting judicial intervention and requiring courts to refer parties to arbitration where a valid agreement exists.[17] Judicial pronouncements have consistently emphasized that arbitration is founded on consent and that courts must practice restraint and respect the parties' decision to resolve disputes through an alternative forum.[18]

However, the contractual basis of damages must be interpreted in the context of the broader statutory framework. Parties may legitimately invoke judicial jurisdiction in specific circumstances, and arbitration legislation does not impose an absolute prohibition on recourse to courts. Consequently, the contractual obligation to refrain from litigating cannot be regarded as unconditional. It is imperative to acknowledge this limitation in order to prevent the transformation of a mechanism that is intended to enforce arbitration into one that penalizes

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[12] Hadley v. Baxendale, (1854) 156 Eng. Rep. 145 (Exch.); Indian Contract Act, No. 9 of 1872, § 73 (India).
[13] Julian D.M. Lew et al., Comparative International Commercial Arbitration 347–49 (2003).
[14] The Angelic Grace, [1995] 1 Lloyd's Rep. 87, 96 (CA).
[15] Union of India v. McDonnell Douglas Corp., (1993) 2 Lloyd's Rep. 48.
[16] Indian Contract Act,1872, §§ 73–74, No. 9, Acts of Parliament, 1872 (India).
[17] Arbitration and Conciliation Act, 1996, §§ 5, 8, No. 26, Acts of Parliament,1996 (India).
[18] Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd., (2011) 5 SCC 532; Vidya Drolia v. Durga Trading Corp., (2021) 2 SCC 1.

the legitimate exercise of statutory rights.

III. STATUTORY ARCHITECTURE, JUDICIAL SUPERVISION, AND THE STRUCTURAL LIMITS OF THE NEGATIVE COVENANT

The negative obligation not to litigate that is embodied in an arbitration agreement, operates within a limited statutory framework. The goal of the developing arbitration sphere is to limit and organize judicial involvement rather than to completely eradicate it.[19] This calibrated design is reflected in the Arbitration and Conciliation Act, 1996. Although Section 5 restricts judicial participation unless specifically specified, the Act also maintains some situations in which courts have the authority to take action.[20]

Section 8 requires courts to determine whether a valid arbitration agreement exists, before referring parties to arbitration.[21] In circumstances of default, Section 11 permits the appointment of arbitrators by judges.[22] Section 16 empowers arbitral tribunals to make decisions based on their own jurisdiction by incorporating the kompetenz-kompetenz principle, but it does not exclude further judicial scrutiny.[23] Additionally, Section 34 allows awards to be revoked for a number of reasons, such as lack of jurisdiction and illegality of the arbitration agreement. These clauses show that using the courts in cases involving arbitral authority is a structural feature of the law rather than an anomaly.[24]

Indian jurisprudence reinforces this interpretation. The Supreme Court has clarified that courts retain the power to undertake a prima facie examination of arbitrability at the referral stage.[25] It was also held that disputes involving rights in rem were non-arbitrable.[26] Similarly, the confined scope of judicial inquiry was affirmed while also acknowledging the supervisory role of courts.[27] Collectively, these decisions confirm that arbitration in India is not insulated from judicial scrutiny.

Against this backdrop, the recognition of damages for breach of arbitration agreements

[19] UNCITRAL Model Law on International Commercial Arbitration art. 5 (1985, amended 2006).
[20] Arbitration and Conciliation Act, 1996, § 5, No. 26, Acts of Parliament,1996 (India).
[21] Arbitration and Conciliation Act, 1996, §8, No. 26, Acts of Parliament,1996 (India).
[22] Arbitration and Conciliation Act, 1996, § 11, No. 26, Acts of Parliament,1996 (India).
[23] Arbitration and Conciliation Act, 1996, § 16, No. 26, Acts of Parliament,1996 (India).
[24] Arbitration and Conciliation Act, 1996, § 34, No. 26, Acts of Parliament,1996 (India).
[25] Vidya Drolia v. Durga Trading Corp., (2021) 2 SCC 1.
[26] Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd., (2011) 5 SCC 532.
[27] Mayavati Trading Pvt. Ltd. v. Pradyuat Deb Burman, (2019) 8 SCC 714.

introduces a paradox. If the initiation of court proceedings is automatically characterized as a contractual breach, the statutory architecture permitting judicial intervention risks being violated. The negative covenant not to litigate cannot be interpreted so broadly as to penalize parties for invoking jurisdiction that the statute itself protects.[28]

Moreover, jurisdictional disputes frequently involve complex and evolving questions of law. Nuanced judicial acumen is at play while determining whether a dispute falls within the scope of an arbitration clause, whether the agreement is void or inoperative, or whether the subject matter is arbitrable often requires.[29] The mere failure of such a challenge does not necessarily imply repudiation of the arbitration agreement. Conflating unsuccessful litigation with wrongful litigation collapses the distinction between statutory recourse and contractual breach.

The structural design of the ACA therefore imposes inherent limits on the enforceability of the negative covenant. Arbitration agreements are enforceable, but their enforcement must remain consistent with the supervisory scheme contemplated by the legislature. Any damages regime must operate within and not against this statutory balance.

IV. PUBLIC POLICY, OVER-DETERRENCE, AND THE FORMULATION OF A CALIBRATED LIABILITY STANDARD

The unqualified recognition of damages for breach of arbitration agreements raises significant public policy concerns. Consent is the bedrock of arbitration. It presupposes the continued availability of judicial mechanisms to question the validity and scope of that consent, if and when necessary.[30] A regime that penalizes parties merely for invoking judicial jurisdiction may operate as an indirect restraint on legal proceedings.

Indian contract law, renders void, agreements that absolutely restrain a party from enforcing its rights through usual legal proceedings.[31] Arbitration clauses survive this provision because they substitute an alternative adjudicatory forum rather than extinguish remedies altogether.[32] However, if damages attach automatically to unsuccessful court proceedings, the effect may resemble a contractual penalty on access to justice. Such an outcome risks disturbing the

[28] Gary B. Born, International Commercial Arbitration 1125–30 (3d ed. 2021).
[29] Redfern & Hunter, Law and Practice of International Commercial Arbitration 103–07 (6th ed. 2015).
[30] Born, supra note 10, at 1132–35.
[31] Indian Contract Act,1872, § 28, No. 9, Acts of Parliament, 1872 (India).
[32] Id.

equilibrium between arbitral autonomy and judicial supervision that Indian arbitration law seeks to maintain.

A further danger lies in over-deterrence. If parties anticipate compensatory liability whenever a jurisdictional objection fails, they may refrain from raising legitimate challenges, even in cases involving arguable questions of statutory interpretation, public policy, or non-arbitrability.[33] The chilling effect would undermine the legitimacy of arbitration by insulating potentially invalid proceedings from scrutiny.

Comparative jurisprudence suggests a narrower and more principled approach. English courts, while acknowledging the enforceability of arbitration agreements, have generally confined remedial consequences to situations involving vexatious or oppressive litigation.[34] The emphasis lies not on the outcome of the proceedings but on the presence of bad faith or procedural abuse. International scholarship similarly advocates a contextual inquiry focusing on reasonableness and intent rather than mere non-compliance.[35]

A coherent doctrinal standard must therefore distinguish between bona fide jurisdictional challenges and abusive litigation tactics. Relevant considerations may include:

- The arguability and legal plausibility of the jurisdictional objection;
- The existence of prior adverse determinations on identical issues;
- The multiplicity or strategic timing of proceedings;
- Evidence of delay, harassment, or forum shopping.[36]

Where proceedings are initiated solely to obstruct arbitration, increase costs, or secure commercial leverage, compensatory damages limited to foreseeable losses (particularly legal costs) may be justified under Section 73 of the Indian Contract Act.[37] Conversely, where the challenge is grounded in genuine legal uncertainty or statutory interpretation, liability should

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[33] Vidya Drolia v. Durga Trading Corp., (2021) 2 SCC 1.
[34] The Angelic Grace, [1995] 1 Lloyd's Rep. 87 (CA); Union of India v. McDonnell Douglas Corp., (1993) 2 Lloyd's Rep. 48.
[35] Julian D.M. Lew et al., Comparative International Commercial Arbitration 352–55 (2003).
[36] K.K. Modi v. K.N. Modi, (1998) 3 SCC 573.
[37] Indian Contract Act,1872, § 73, No. 9, Acts of Parliament, 1872 (India).

not arise merely because the court rejects the argument.

By doing this, arbitration agreements maintain their enforceability without becoming tools of procedural absolutism. It guarantees that damages don't serve as a punishment for poor legal reasoning, but rather as a deterrence against bad-faith obstruction. Courts can uphold the integrity of the arbitral process and contractual sanctity by reinstating the distinction between irregularity and outcome.

V. CONCLUSION

An important doctrinal development in modern arbitration law is the acknowledgment of damages for breach of arbitration agreements. It shows a court's dedication to enhancing party sovereignty and making sure that parallel or opportunistic action doesn't make arbitration arrangements illusory. Parties make a commitment that structures their procedural rights and business expectations when they decide to arbitrate. Ignoring that promise can lead to litigation that reduces efficiency, raises costs, and erodes the assurance arbitration aims to deliver. However, as this study has shown, the negative covenant not to litigate cannot be completely enforced. The legal and constitutional framework that governs arbitration specifically protects minimal judicial intervention. At the core of arbitral power are issues related to validity, scope, consent, and arbitrability.

Doctrinal calibration is when the proper equilibrium is found. Only in cases where court proceedings are clearly oppressive, vexatious, or conducted in bad faith could damages be allowed. The validity of the legal position put out, the surrounding procedural environment, and the existence of abusive or dilatory purpose must be the main topics of the investigation. Without punishing valid jurisdictional objections, compensating liability can serve as a deterrence against strategic arbitration evasion.

Ultimately, preserving a moral balance between procedural justice and contractual enforcement is what makes arbitration so effective. The statutory protections that uphold arbitral validity can be preserved while courts uphold the sanctity of arbitration agreements by restricting damages to instances of egregious abuse.