PRE-REFERRAL EXAMINATION ON VALIDITY OF ARBITRATION AGREEMENTS: IN SEARCH OF THE RIGHT BALANCE

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ABSTRACT

In the realm of arbitration law, the courts have witnessed a significant evolution in their approach to examining the validity of arbitration agreements. The courts have primarily taken two core approaches while balancing party autonomy and determination of the existence of a valid arbitration agreement. While the traditional approach allows courts full discretion to rule on the presence and legality of arbitration agreements, the liberal approach confines the review to a prima facie level initially. The 2015 amendments to the Arbitration and Conciliation Act, 1996 introduced a new regime, notably altering Section 11 of the Act by incorporating subsection (6A). This amendment restricted the courts to a prima facie assessment of the existence of a valid arbitration agreement. Similar amendments to Sections 8 & 45 also seek to curtail judicial intervention by mandating arbitration referrals unless clear evidence disproves the existence or validity of an arbitration agreement. However, these amendments have not fully succeeded in achieving their desired objectives. It is felt that there is a need for balancing time and cost considerations concerning pre-referral examination in order to prevent parties from being prematurely compelled into arbitration without a valid arbitration agreement while also acknowledging the potential cost implications of lengthy court proceedings after which a party may eventually be required to submit before an arbitral tribunal.

INTRODUCTION

The views of various courts around the world on the extent of examination required to determine the existence and validity of an arbitration agreement under Article 8 of the UNCITRAL Model Law (Section 8 of the Indian Arbitration and Conciliation Act, 1996) vary. In examining the validity of arbitration agreements at the pre-referral stage under sections 8,11 & 45 of the Arbitration and Conciliation Act, 1996 (the Act) courts have primarily followed two approaches.

1) *Traditional Approach* - This approach allows a court where a dispute has been brought, despite an arbitration agreement, to fully rule on the existence and validity of the arbitration agreement. The rationale is that proceeding on an invalid agreement would be a fruitless exercise involving much time and expenditure.

2) *Liberal Approach* - This approach restricts the review of the validity of the arbitration agreement to a prima facie level initially. Countries that have adopted this method include Switzerland and those influenced by the UNCITRAL Model Law, such as Hong Kong and Ontario. Under this approach, for final review, the parties may raise the issue before an arbitral forum or after an award is made. For instance, the 1987 Swiss Private International Law Statute stipulates that a Swiss court shall decline jurisdiction unless the court finds that the arbitral agreement is null and void, inoperative, or incapable of being performed, interpreting this as a prima facie verification.

SHIFT IN APPROACH

The court in *Shin-Etsu Chemical Co. Ltd.*[1] acknowledged that while the traditional approach remains, there is an increasing shift towards the liberal approach in various legal systems, both statutorily and through judicial interpretation. In this context it may be noted that a Canadian court emphasized the importance of the right to arbitrate by characterizing it as a "fundamental right".[2]

Section 8 of the Act uses the words "refer the parties to arbitration unless it finds that *prima*

[1] Shin-Etsu Chemical Co. Ltd. v. Aksh Optifibre Ltd. and Another, (2005) 7 SCC 234.
[2] Laurentienne-vie, Cie d'assurances Inc. v. Empire, Cie d'assurance-vie, Court of Appeal of Quebec, Canada, 12th June 2000, [2000] CanLII 9001 (QC CA).

facie no valid arbitration agreement exists"[3] & section 45 of the Act uses the words "refer the parties to arbitration, unless it *prima facie* finds that the said agreement is null and void, inoperative or incapable of being performed"[4]. The amendments[5] to Section 8 aims to reduce judicial interference at the referral stage. By this amendment, judicial authorities are now mandated to refer disputes to arbitration unless there is clear evidence that an arbitration agreement does not exist or is null and void. This change was influenced by the recommendations of the 246th Law Commission Report.

The 2015 amendments[6] resulted in a new regime, also altering Section 11 of the Act by introducing sub-section (6A),[7] which limited courts to solely examining the existence of an arbitration agreement. Previous jurisprudence, such as debates on 'accord and satisfaction,' was overruled by it. Section 11(6A) should be understood narrowly, per the *Duro Felguera* judgment[8], considering only the question of the existence of an arbitration agreement. Further, it is settled law that the scope and ambit of court's jurisdiction under section 8 and section 11 of the Arbitration and Conciliation Act is similar[9]. Holding that sections 8 and 11 have similar scopes regarding judicial interference, indicates a consistent approach in limiting court involvement in arbitrations.

TWO MAIN CHECKS

In *Vidya Drolia and Ors.*[10] the court said that when parties agree to arbitration, there is a presumption that they intend for a one-stop mechanism to resolve all disputes. This presumption is rebuttable, but courts must limit their jurisdiction to what the law expressly provides. The court referred to the decision in *Booz Allen*[11] where it was observed that under Section 11, the Chief Justice or his designate would primarily check for the existence of an arbitration agreement and leave the arbitrability issue for the Arbitral Tribunal to decide. Following an incorrect arbitrability decision by the arbitrator, the aggrieved party must

[3] Subs. by Act 3 of 2016, s. 4, for sub section (1) (w. e. f. 23-10-2015).
[4] Subs. by Act 33 of 2019, s. 11, for "unless it finds" (w.e.f. 30-8-2019).
[5] Amended by Act 3 of 2016 (w. e. f. 23-10-2015).
[6] *Id*.
[7] Ins. by s.6, Act 3 of 2016, (w. e. f. 23-10-2015).
[8] Duro Felguera, SA v. Gangavaram Port Ltd., (2017) 9 SCC 729.
[9] SBP & Co. v. Patel Engineering Ltd. and Another, (2005) 8 SCC 618 (Majority judgment of the constitution bench of seven judges).
[10] Vidya Drolia and Ors. v. Durga Trading Corporation, (2021) 2 SCC 1.
[11] Booz Allen and Hamilton Inc. v. SBI Home Finance Ltd., (2011) 5 SCC 532.

challenge the award under Section 34 of the Act. The court in Vidya Drolia[12] further observed – *"Having said so, in clear cases where the subject matter arbitrability is clearly barred, the Court can cut the deadwood to preserve the efficacy of the arbitral process."*

In *Gujarat Composite Ltd.*[13] the apex court observed that Courts should refer a matter to arbitration unless it finds prima facie (summarily) that there is no valid arbitration agreement. This decision aligns with the principle that in cases of doubt, matters should be referred to arbitration to uphold the efficacy of arbitration as an alternative dispute resolution mechanism.

Only those cases considered "deadwood," where the arbitration agreement is blatantly invalid or non-existent, should not be referred to arbitration. When there's ambiguity or doubt, referral to arbitration is recommended. The court cited the case of Vidya Drolia[14] which discusses the broader interpretation and application of Section 8. It clarified that the judicial authority should refer the case to arbitration if the arbitration agreement exists prima facie, leaving detailed analysis to the Arbitral Tribunal.

The Apex court in *Gujarat Composite Ltd*[15] answered some very crucial questions to clear the air on the matter, if at all any confusion remained. It observed that Sections 8 and 11 of the Act have the same ambit with respect to judicial interference. Usually, subject-matter arbitrability cannot be decided at the stage of Section 8 or 11 of the Act, unless it is a clear case of deadwood. The court, under Sections 8 and 11, has to refer a matter to arbitration or to appoint an arbitrator, as the case may be, unless a party has established a prima facie (summary findings) case of nonexistence of valid arbitration agreement, by summarily portraying a strong case that he is entitled to such a finding. The court should refer a matter if the validity of the arbitration agreement cannot be determined on a prima facie basis, as laid down above i.e., "when in doubt, do refer". The scope of the court to examine the prima facie validity of an arbitration agreement includes only: 1) Whether the arbitration agreement was in writing? or 2) Whether the arbitration agreement was contained in exchange of letters, telecommunication, etc.? or 3) Whether the core contractual ingredients qua the arbitration agreement were fulfilled? or 4) On rare occasions, whether the subject-matter of dispute is arbitrable?"

[12] Vidya *Supra* Note 10.
[13] Gujarat Composite Ltd. v. A Infrastructure Ltd., (2023) 7 SCC 193.
[14] Vidya *Supra* Note 10, at 3.
[15] Gujrat *Supra* Note 13.

STAMPING & OTHER ASPECTS

The court[16] observed that jurisdictional and complex factual questions, such as those arising under the *group company doctrine or good faith, etc in multi-party arbitrations*, should ideally be dealt with by the Arbitral Tribunal rather than courts.

In *Re: Interplay*[17] it was held that a court can under section 9 of the Act grant relief even if the arbitration agreement or the main agreement of which the arbitration agreement forms part, is unstamped or insufficiently stamped. Such agreements are not inherently void / unenforceable and hence they are deemed curable defects. Objections relating to stamping shall not lie under section 9 or 11 of the Act but any such objection may be raised before the arbitration tribunal.

However, the court in this case did not deal with the issue of non-registration of compulsorily registrable documents and hence this aspect will be governed by the earlier decision in *SMS Tea Estate*[18], where it was held that such non-registration would not bar the court's power of referral to arbitration.

In *Sushma Shivkumar Daga*[19] the court clarified that for an application under Section 8, the existence of an arbitration agreement is essential. The top court again emphasized that the role of the court is limited in arbitration matters. It referenced Section 5 of the Act which restricts judicial intervention except as provided in the Act and the amendments made to Section 8 and Section 11 in 2015[20] further reduced the scope of judicial interference.

The appellants in this case argued that the Conveyance Deed dated 17.12.2019 and several development agreements lacked an arbitration clause. The Respondents pointed out that these documents derived their authority from two Tripartite Agreements dated 31.03.2007 and 25.07.2008, which did contain broad arbitration clauses. Both the Trial Court and the High Court agreed that these arbitration clauses adequately covered the disputes raised by the appellants. This court also held that the development agreements in question find their source in the two Tripartite Agreements, which contain arbitration clauses.

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[16] *Id*.
[17] In Re: Interplay Between Arbitration Agreements under the Arbitration and Conciliation Act, 1996 and the Indian Stamp Act, 1899, 2023 INSC 1066 (Majority judgment of the constitution bench of seven judges).
[18] SMS Tea Estates (P) Ltd. v. Chandmari Tea Co. (P) Ltd., (2011) 14 SCC 66.
[19] Sushma Shivkumar Daga & Anr. v. Madhurkumar Ramkrishnaji Bajaj & Ors., 2023 INSC 1081.
[20] Act *Supra* Note 5, at 3.

The appellants contended that their suit for the cancellation of a document related to immovable property amounted to an action in rem, not subject to arbitration. The Court, referring to its decision in *Deccan Paper Mills*[21], clarified that whether the suit is for the cancellation of a deed or a declaration of rights stemming from the deed, it constitutes an action in personam as opposed to an action in rem and hence capable of being resolved through arbitration.

The appellants raised an allegation of fraud to prevent jurisdiction from being transferred to arbitration. The court noted that the appellants' fraud claim was unsubstantiated and merely a bald assertion. It was highlighted that for a plea of fraud to oust the arbitrator's jurisdiction, it must be serious and substantial. The consistent stance of the court has been that only significant fraud allegations can undermine the arbitrator's authority.

In each instance, the judgement underscores the judiciary's preference for upholding arbitration agreements and minimizing judicial interference, aligning with the principles established under the Act, particularly after the 2015 amendments.

MODIFIED STANCE – HYBRID APPROACH

In *Magic Eye Developers Pvt. Ltd.*[22] the court dealt with Section 11(6A) of the Act and its implications regarding the existence of an arbitration agreement. It held that courts must *conclusively decide* on the arbitration agreement's existence and validity, not leaving it for the arbitration tribunal so that it is ensured that parties aren't forced into arbitration unnecessarily without a valid agreement and without a valid agreement, arbitration can't proceed. If the referring court doesn't definitively decide on the agreement, it might violate Section 11(6A) of the Act.

The Court explained that with regard to the question of validity of an arbitration agreement, as the same goes to the root of the matter, the same has to be to conclusively decided by the referral court at the referral stage itself. On the other hand, as regards the question of non-arbitrability of the dispute is concerned, relying on the decision in Vidya Drolia, it held that the courts at pre-referral stage and while examining the jurisdiction under Section 11(6) of the Act may only consider prima facie examination of the same.

[21] Deccan Paper Mills v. Regency Mahavir Properties, (2021) 4 SCC 786.
[22] Magic Eye Developers Pvt. Ltd. v. M/s. Green Edge Infrastructure Pvt. Ltd. & Ors., 2023 SCC OnLine SC 620.

Recently in *Shri Ashwin Digmabar*[23] Karnataka High Court held in relation to Section 8 of the Act that the courts should refer a matter to arbitration if there is a valid arbitration agreement and if the nature of the allegations doesn't require extensive evidence which the court should better handle. In very serious allegations of fraud "*or where allegations of fraud are so complicated that it becomes absolutely essential that such complex issues can be decided only by civil court on the appreciation of the voluminous evidence* that needs to be produced, the Court can sidetrack the agreement by dismissing (the) application under Section 8 and proceed with the suit on merits"

It is humbly submitted that the court may have read another condition for referring a matter to arbitration i.e., in complex allegations of fraud requiring voluminous evidence the court may not refer the matter to arbitration. It is pertinent to note that very recently an appeal before the Hon'ble Supreme Court has been preferred against the verdict of the Hon'ble High Court and a decision on the same is pending[24].

The court cited various decisions of the apex court including the decision in Rashid Raza[25] differentiating between serious and simple allegations of fraud in arbitration. Serious fraud allegations, which impact the validity of the entire contract and the arbitration agreement, are to be handled by civil courts. In contrast, simple fraud allegations, confined to internal affairs without public implications, could be arbitrated.

With regard to section 11 of the Act, the court relying on *Magic Eye*[26] held if the validity and existence of the arbitration agreement are in question, the referral court must *conclusively resolve* this issue before referring the matter to arbitration to prevent unnecessary arbitration when no valid agreement exists.

DECIDING THE TIMELINE

The court in *Shin Etsu Chemical Co. Ltd*.[27] had said that under Section 45 of the Act, the determination has to be on merits, final and binding and not prima facie. However, one cannot place reliance on this aspect of the decision since it was rendered much before the Arbitration

[23] Shri Ashwin Digmabar Raikar vs Shri. Pyaro Baig, 2024 KHC 3757, decided on 29th Jan 2024.
[24] Diary No. 30890-2024 IV-A (As on 19/07/2024 the matter appeared in Serial no. 43 of the Supplemental List for Admission).
[25] Rashid Raza Vs. Sadaf Akhtar, (2019) 8 SCC 710.
[26] Magic *Supra* Note 22, at 6.
[27] Shin *Supra* Note 1, at 2.

& Conciliation (Amendment) Act, 2019[28] came into force which has substituted the words "unless it finds" with the words "unless it *prima facie* finds" in section 45 of the Act.

Notably, the significant aspect of this decision lies in the observation that any application filed under Section 45 of the Act *must be decided within three months* of its filing. In rare and exceptional cases, the judicial authority may extend the time by another three months, but by sending a report to the superior/appellate authority setting out the reasons for such extension.

Thus, the court felt that three months (90 days) may be enough in most cases to decide the validity of the arbitration agreement conclusively. Interestingly, the Expert Committee on Arbitration[29] has recently suggested a *non-mandatory timeline of 60 days* for deciding the validity of an arbitration agreement on an application filed under section 8 of the Act. This may be seen as a further indication of the legislative trend towards the prima facie approach.

However, one size fits all approach may not be the answer to the problem of delay in the pre referral stage. Probably, this realization had inspired the Expert committee to indicate that the timeline of 60 days is only *directory* in nature. It may not be out of place if a few questions in this regard creep up in the mind – Will the non-mandatory timeline practically reduce the time consumed in pre-referral litigation? Should India rather adopt a mandatory timeline keeping in view it's peculiar conditions and the fact that a party may well be required to arbitrate after bearing the cost of lengthy court proceedings if the court eventually decides to refer the matter to arbitrator?

The Legislature gauged this road block way back in 2003 and, albeit unsuccessfully, tried to grab the bull by the horns through introduction of an amendment in section 8 of the Act.[30] The proposed amended section 8 said that the court at the pre-referral stage shall stay the proceeding if a decision on any of the following "preliminary issues" is required to be made: (a) whether any dispute is in existence or (b) whether the arbitration agreement or any clause thereof is null and void or inoperative; or (c) whether the arbitration agreement is incapable of being performed; or (d) whether the arbitration agreement is not in existence. However, if any of the

[28] Act Supra Note 4, at 3.
[29] An expert committee headed by Dr. T.K. Viswanathan was set up by the central government on 12.06.2023, to examine the working of arbitration law in India and to recommend reforms in the Arbitration and Conciliation Act, 1996. The committee submitted its final report to the government on 15.02.2024.
[30] The Arbitration and Conciliation (Amendment) Bill, 2003 (As introduced in Rajya Sabha on the 22nd December, 2003).

above questions cannot be decided because: a) Related facts/documents are disputed or, b) Oral evidence is required or c) "*enquiry is likely to delay reference to arbitration*" or d) ……..... "it *shall refuse to decide the question and refer* the same to the arbitral tribunal for decision."

TIMELINE - THE WAY FORWARD

It is humbly submitted that keeping in view the existing section 8(3) of the Act, a better approach may be that after completion of the non-mandatory time period of 60 days as suggested by the committee, if the matter is still pending for decision, the process of submitting the dispute to Arbitration, except the actual formation of Arbitration Tribunal, may mandatorily commence. The Tribunal may be formed within a fixed time only after the court's final order, if any, is made referring the dispute to arbitration within the further 'mandatory' time period as may be fixed after expiry of the initial 60 days. If the case is disposed of without making a referral order within the mandatory time period (as may be fixed), the initial process for arbitration shall end. Conversely, if the matter still awaits disposal on the expiry of the mandatory time period, the matter may be mandatorily transferred to the tribunal which may proceed to hear the matter from the stage up to which it was heard by the court.

CONCLUSION

The observations made in various judgements of the courts and the attempted amendments / amendments to the Act collectively reinforce the ethos that arbitration should be the preferred mode of dispute resolution, with minimal judicial intervention unless the arbitration agreement is clearly invalid or non-existent. The consistent thread through all of them is the promotion of arbitration's integrity and practicality in resolving disputes efficiently.

There have been instances where the courts were reluctant to refer the dispute to arbitration considering the facts of the case, particularly where serious and substantiated allegations of fraud were raised. The present landscape of pre-referral examination of arbitration agreements suggests that courts in the future may do well to keep in mind the considerations of time and cost. This means creating a balance between ensuring that the parties are not forced into arbitration unnecessarily without a valid arbitration agreement and at the same time recognizing that a party may well be required to arbitrate after bearing the cost of lengthy court proceedings if the court eventually decides to refer the matter to arbitration. It may be

remembered that the other strand of this lies in equipping the arbitrators with the necessary wherewithal to ensure that they are capable of dispensing complete justice.

REFERENCES

1. The Arbitration and Conciliation Act, 1996
2. UNCITRAL 2012 Digest of Case Law on the Model Law on International Commercial Arbitration.
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