UNIT-I

Arbitration Agreement

SUBJECT - Alternative Dispute Resolution

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ARBITRATION AGREEMENT

DEFINITION UNDER Section 7

INTERPRETATION OF Section 7

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Section 7 – Definition:

The arbitration agreement provides the basis for arbitration. It is defined as an agreement to submit present or future disputes to arbitration. By entering into an arbitration agreement, the parties commit to submit certain matters to the arbitrators' decision rather than have them resolved by law courts. Thus, the parties:

a) Waive their right to have those matters resolved by a court; and
b) Grant jurisdictional powers to private individuals (the arbitrators).

Thus arbitration agreement has two fold results -

1. ***Negative enforcement: Ouster of jurisdiction of courts*** - An arbitration agreement precludes judges from resolving the conflicts that the parties have agreed to submit to arbitration. If one of the parties files a lawsuit in relation to those matters, the other may challenge the court's jurisdiction on the grounds that the jurisdiction of the courts has been waived.
2. ***Positive enforcement: The "submission agreement"***- The arbitration agreement grants jurisdiction to arbitrators. By "jurisdiction", i.e. the powers conferred on arbitrators to enable them to resolve the matters submitted to them by rendering a binding decision.

This generic concept comprises two basic types:

a) A clause in a contract, by which the parties to a contract undertake to submit to arbitration the *disputes that may arise* in relation to that contract (arbitration clause); or
b) An agreement by which the parties to a dispute that has already arisen submit the dispute to arbitration (submission agreement).

Therefore, the arbitration clause refers to disputes not existing when the agreement is executed. The submission agreement refers to conflicts that have already arisen.

Example - Company 'A', a car making company enters into an agreement with Company 'B' a tyre making co. for supply of tyres for its cars in 2017.

Case 1 - the agreement consists of a clause stating that all disputes shall be arbitrated in Mumbai. It is contained in principal contract and no disputes have arisen yet. It concerns future disputes that may arise.

Case 2 - the agreement has no clause relating to arbitration disputes that arose between the parties in 2019. Subsequently, to resolve the dispute, parties entered into an agreement that "all disputes relating to quality of tyres shall be submitted to arbitration" This is submission agreement.

Under Indian law every individual has an inherent right to approach the court for resolution of dispute. This right cannot be contracted or taken away, otherwise will be hit by Section 28 of ICA. But arbitration agreement is an exception under this provision.

GENERAL PRINCIPLES

1. Arbitration agreement is an agreement enforceable under the law. In other words it is a contract, and has to fulfill all requirements/essentials of a valid contract.
2. **Consensus ad idem** - Section 29 requires that agreements meaning of which is not certain or capable of being made certain are void. Thus the intention of parties to enter into arbitration must be clearly made out from the agreement. If the terms are ambiguous or uncertain, there cannot be an agreement.

3. **Ouster of Jurisdiction** - Once the parties agree to arbitrate, their matter, neither of them can unilaterally proceed to the court to litigate that matter. Any party doing so would be referred to arbitration u/s 8 of the Act.
4. **Doctrine of Seperability** - The doctrine provides that arbitration agreement even though contained in the same contract is a separate contract in itself. This is done to ensure that the agreement to arbitrate would not be rendered invalid merely because the principal contract was invalid. This is legal fiction. It is provided under Sec 16 of the Act.

ESSENTIAL ELEMENTS

1. **In writing** - Oral agreement to submit the dispute to arbitration is not binding. It is in writing if contained in-
   - ✓ A document signed by the parties
   - ✓ Exchange of letters, fax telegram , which form some mode of communication
   - ✓ Exchange of statement of claim and defence , in which the existence of an agreement is alleged by one party and not denied by the other;
   - ✓ A reference in the contract to any document containing such arbitration clause - provided contract is in writing.

   For example, the acceptance of tender which carries an arbitration clause is sufficient.

   Eg.- C owns a readymade cloth shop. D is the cloth supplier. No separate written contract exists between them. However, for each consignment, D issues an invoice to C, based on which the payment is made. Each invoice contains the following not 'all disputes pertaining to this transaction shall be subj to arbitration in delhi". This is arb agreement.

   Although, it has to be in writing, there is no prescribed form of agreement. If the intention of parties to refer the arbitration can be ascertained from the terms of agreement, it is immaterial whether or not terms' arbitrator'/ 'arbitration' have been used.

2. **Mutual Consent**- It must arise out of mutual consent of the parties.
3. **Clarity of consent**- the intention to go to arbitration must be in clear terms. The intention has to be gathered from the words of the agreement.

4. **Mandatory requirement**- There should be a mandatory requirement for settlement of disputes by arbitration. Their intention to submit to arbitration must unequivocally arise from the agreement. It must be clear and mandatory requirement. An arbitration agreement written in terms too ambiguous or generic, which does not restrict its scope to the disputes arising from a particular juridical relation, would not be acceptable.
5. **Legal Relationship**- The provision requires that, dispute must be with regard to a defined legal relationship whether contractual or not. Matters of spiritual or moral subject are not arbitrable in nature. The dispute can be in present or in future.
6. **Legal Capacity** - The parties must have legal capacity. Capacity is one of the general requirements to enter into any agreement. The arbitration agreement is subjected to the same rules applicable to the validity of contracts in general, which means that the lack of capacity usually makes the whole act void.
7. **Arbitrable Subject Matter**- The subject matter must be arbitrable. Every civil dispute, either contractual or non-contractual in nature which can be decided by the court is primarily arbitrable.

Matters which cannot be referred to arbitration -

a) Insolvency proceedings
b) Matrimonial disputes - divorce, judicial separation, restitution of conjugal rights, custody of child etc.- except settlement of terms of separation
c) Industrial disputes
d) Guardianship matters
e) Winding up of a company
f) Cases arising out of trust act

Thus, generally all disputes relating to Rights in Personam, i.e. rights and interests of parties exercisable between the parties themselves are arbitrable. While Rights in Rem, i.e. exercisable against the world at large are not subjected to arbitration. But, this is not a fixed rule.dcv

- **Burden of Proof** - the burden of proving existence of a valid contract containing an arbitration clause rests first with the party who moves application for arbitration.

- **Effect of a void agreement on the arbitration clause** - The jurisdiction of an arbitrator to hear and decide a dispute is derived from an arbitration Agreement. Where there is no such agreement, there is initial want of jurisdiction which cannot be cured by acquiescence. When a contract contains an arbitration agreement, it is a collateral term relating to the resolution of disputes, unrelated to the performance of the contract. It is as if two contracts- one in regard to the substantive terms of the main contract and other relating to resolution of disputes- had been rolled into one, for the purpose of convenience. An arbitration clause is therefore an agreement independent of the other terms of the instrument. Thus, of the contract is terminated due to repudiation, frustration or breach of contract, the arbitration agreement would survive for the purpose of resolution of dispute.

REFERENCE BY COURT

Section 8

The Arbitration & Conciliation Act intends to help the parties to settle their differences without resorting to vexatious litigation. If the matter covered by arbitration could still be litigated upon, the arbitration instead of being cheaper, less time consuming and alternative to litigation, would involve duplicity of expenditure, ultimately defeating the essence of the act. Section 8 is a step in this direction. It empowers the court to refer the parties to arbitration where there is an Arbitration Agreement (AA). The provision states that, if any party to an AA brings before the judicial authority the matter covered by the agreement, the other party may apply for stay of the suit and for order of reference for arbitration. The provision is mandatory in nature and the court is bound to refer the matter to arbitration. So long as the matter is arbitrable.

In the matter of **Ashok Thapar v. Tarang Exports (P) Ltd**, [2018 SCC Online Bom 1489] it was observed that:

"*The purpose of the Arbitration and Conciliation Act, 1996 is to minimize the burden of the Courts so also to expedite the matters. Once the parties have intended to refer their dispute to the Arbitrator in their Agreement, and then any dispute pertaining to the contents of the Agreement or touched the subject matter of the Agreement is necessarily to be referred to the Arbitrator even though Arbitration Agreement is mutually terminated by both the parties*"

Under this provision the court has to decide on following points-

a) Whether there is an Arbitration Agreement among the parties
b) Whether all the parties to the suit are parties to Arbitration Agreement
c) Whether the disputes which are subject matter of the suit fall within the scope of arbitration agreement
d) Whether the defendant had applied under Section 8 for reference before submitting his first statement on the substance of the dispute, and
e) Whether the reliefs sought in the suit are such as can be adjudicated and granted in arbitration.

It is beyond the scope of enquiry to examine whether a suit is maintainable or barred under substantive contract while adjudicating on the validity of the Arbitration Agreement u/s 8

Hindustan Petroleum Corporation Ltd. v. M/s Pink City Midway Petroleum [(2003) 6 SCC 503]- In this case SC held that the jurisdiction of Civil Court is barred after an application under Section 8 of the Act is made for arbitration.

P Anand Gajapathi Raju v. P.V.G. Raju (2000) - The SC held as follows-

a) There must be an Arbitration agreement
b) A party to the agreement brings an action in the Court against the other party.
c) The subject matter of action is same as the subject matter of the arbitration.
d) The other party moves to the court for referring the parties to arbitration before submitting the first statement on the substance of dispute

NOTE: Also, the phrase, "which is subject matter of an arbitration agreement", does not necessarily require that the agreement must be already in existence before the action is brought in court. The phrase also covers the situation where the arbitration agreement is brought into existence while the action is pending in court.

Difference between Section 89 of CPC & Section 8 of Arbitration & Conciliation Act -

Reference under Section 89 of CPC to any ADR process is possible only under mutual consent of the parties whereas under Section 8 of Arbitration & Conciliation Act it can be ordered at the application of only one party.

TERMINATION OF AGREEMENT

1. **Mutual consent** - the parties can jointly agree to put an end to contract.
2. **Termination of the Principal contract** - If the principal contract is terminated through discharge or novation, the arbitration agreement terminates. However, if the principal contract is breached, then the AA survives because of the operation of doctrine of severability. Example - X air conditioning services co. entered into an agreement with Voltas co. that it will provide servicing for all the Voltas Acs in Lucknow. The agreement provided that in the event of dispute matter would be sent to arbitration.

   Case 1- At the end of 3rd year, service agreement was not renewed. The AA comes to an end along with the main agreement.

   Case 2- At the end of the 2nd year, parties enter into a new contract which does not have an arbitration clause. The previous AA comes to an end and now disputes cannot be subjected to arbitration.

   Case 3- Voltas raises a dispute with co. X regarding the quality of service and ends the contract. The AA does not end.
3. **Death of parties** - Arbitration is not discharged by death of parties. LRs become the party.
4. **Operation of law**.

NOTE: *In the context of arbitration agreements, the requirement of valid consideration means that the arbitration agreement must contain an explicit mutual exchange of promises to arbitrate. Accordingly, an arbitration agreement that only requires one side to submit its problems to arbitration has no mutuality of obligation and thus is not a valid, enforceable arbitration agreement.*

DOCTRINE OF SEPERABILITY AND PRINCIPLE OF KOMPTEZ- KOMPTEZ

The Doctrine of Seperability - means that the arbitration clause in a contract is considered to be separate from the main contract of which it forms part and, as such, survives the termination of the contract. As per this doctrine, an arbitration clause which forms the part of the contract shall be treated as agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail *ipso j*ure the invalidity of the arbitration clause. ***In Mulheim Pipecoatings Gmbh* V/s *Welspun Fintrade Ltd.***, 2013 SCC Online Bom 1048 it was observed that

- The arbitration agreement constitutes a **"collateral term"** in the contract which relates to the resolution of disputes and not to the performance of the contract. Whereas the substantive terms of a contract define the rights and obligations of the parties, an arbitration agreement provides for modalities agreed upon by parties for the resolution of their disputes. Parties agree thereby to have their disputes resolved before an arbitral tribunal as distinct from the ordinary courts of law in the jurisdiction.
- Upon **termination of the main contract,** the arbitration agreement does not ipso facto or necessarily comes to an end.
- The issue as to whether the arbitration agreement survives or perishes along with the main contract would depend upon the nature of the controversy and its effect upon the existence or survival of the contract itself.

1. If the nature of the controversy is such that the main contract would itself be treated as *nonest* in the sense that it never came into existence or was void, the arbitration clause cannot operate, for along with the original contract, the arbitration agreement is also void.

2. Similarly, though the contract was validly executed, parties may put an end to it as if it had never existed and substitute it with a new contract. Even in such a case, since the original contract is extinguished, the arbitration clause forming a part of the contract would perish with it.
3. There may, however, be cases where it is. In the circumstances, where the future performance of the contract comes to an end and one or both the parties are discharged from further performance i.e. termination of the contract by one party, repudiation of the contract by one party other and frustration. In all such cases, the contract is not put an end to for all purposes because there may be rights and obligations which had arisen earlier when it had not come to an end. The contract subsists for those purposes and the arbitration clause would operate for those purposes.

Thus it is to be considered, whether it is the further performance of the contract that is brought to end or it is the existence of the contract which is brought to end. In the former case, where the further performance of the contract has been brought to end, the arbitration clause would survive whereas when the existence of the contract itself brought to end, the arbitration clause would not survive. Where the dispute is whether the said agreement is *void ab initio*, the arbitration clause cannot operate on those disputes, for its operative force depends upon the existence of the contract and its validity. But in a case where a contract is validly executed, but comes to an end later, though it comes to an end, it is deemed to be still in existence, for certain purposes in respect of disputes arising under it or in connection with it. Therefore, the arbitration clause in such a contract does not perish. Any dispute arising under the said contract is to be decided as stipulated in the arbitration clause.

Whether the contract has come to an end in the manner stipulated in the contract itself is a dispute. Therefore, notwithstanding the contract coming to an end, the arbitration clause persists and even that dispute is to be resolved in terms of the arbitration clause contained in the agreement.

Principle of Kompetenz Kompetenz- the principle of kompetenz-kompetenz recognizes the competence of an

arbitral tribunal to rule on its own jurisdiction, including ruling on any objections, with respect to the existence and validity of the arbitration agreement. It is a method of overcoming the latent problem that would have occurred where a tribunal decides preliminary that the arbitration agreement for example is invalid. The resultant effect would have been that the arbitral tribunal itself lacks the authority to make that finding. The principle gives the tribunal the legal standing to set proceedings in motion when faced with an objection raised by an uncooperative respondent.

It is a method of overcoming the latent problem that would have occurred where a tribunal decides preliminary that the arbitration agreement for example is invalid. The resultant effect would have been that the arbitral tribunal itself lacks the authority to make that finding. The principle gives the tribunal the legal standing to set proceedings in motion when faced with an objection raised by an uncooperative respondent. Although arbitrators have authority to rule on their jurisdiction, they cannot do it on their own initiative. Sec 16 of the A&C act incorporates the principle.

Relation between doctrine of separability and Kompetenz Kompetenz-

Historically, it was held that an arbitration agreement contained in a contract was accessory to the main contract and that the invalidity of the contract also entailed the invalidity of the arbitration agreement. On the basis of that interpretation, arbitral jurisdiction was frequently restricted by challenges to the validity of the contract, since those challenges involved the arbitrators' jurisdiction as well.

The argumentative line was as follows:

- If the main contract is null and void, so is the arbitration agreement that is accessory to it;
- If the arbitration agreement is considered null and void, arbitrators lack jurisdiction to solve any of the question relating to such contract, including whether the contract is invalid or not;
- As the validity of the arbitration agreement is being questioned, arbitrators must not intervene until a court decides the matter.

In this way, the mere filing of such a defence would entail an obstacle to arbitration.

In order to avoid this situation, most modern laws and rules on arbitration have included two main principles: the principle of "separability", "autonomy" or "independence" of the

arbitration clause, and that of “Kompetenz Kompetenz”. Since the arbitration agreement is currently regarded as autonomous or separate from the main contract, the invalidity of the contract does not entail the automatic invalidity of the arbitration agreement. Moreover, as arbitrators are empowered to examine and rule on pleas raised against their jurisdiction, the arbitration is not teminated or suspended by the mere raising of a motion that the arbitrators lack jurisdiction. However, it must be noted that even though the principle of Kompetenz-Kompetenz empowers arbitrators to initially decide the plea for lack of jurisdiction, their decision is subject to subsequent judicial review.

This enabled arbitrators to retain jurisdiction and solve the disputes, even those related to the validity or invalidity of the contract. Otherwise, the mere contention of invalidity of the contract would imply neutralizing the effects of the arbitration agreement. This would, in turn, mean invalidating the method chosen by the parties to settle the conflict. The ultimate argument of these provisions is that the arbitration clause is not just another clause within a contract. It is a special agreement to confer jurisdiction on the arbitrator empowering them to rule on all questions related to the contract, even those relating to their own jurisdiction.