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SUPREME COURT STRIKES DOWN CLAUSE MANDATING PAYMENT OF DEPOSIT AS PRE-CONDITION TO INVOKING ARBITRATION

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The Supreme Court, in its recent judgment in *ICOMM Tele Ltd. v Punjab State Water Supply and Sewerage Board & Anr.*, delivered on 11 March 2019, has ruled on the validity of an arbitral clause mandating deposit of a certain percentage of the claim amount as a pre-condition for initiating arbitration.

FACTS

In 2008, the Punjab State Water Supply and Sewerage Board (First Respondent) issued a notice for tender for the extension and augmentation of water supply, sewerage scheme, pumping station and sewerage treatment plant for various towns. ICOMM Tele Ltd. (Appellant) successfully contested for the same and on 16 January 2009, a formal contract was entered into between the Appellant and the Executive Engineer, Punjab State Water Supply and Sewerage (Second Respondent), which contract incorporated the notice for tender.

The notice for tender contained a detailed arbitration clause, which, in Clause 25(viii) provided that any party invoking arbitration shall, *inter alia*, "*furnish a 'deposit-at-call' for 10% of the amount claimed*." In the event of the award being passed in the claimant's favour, this deposit would be refunded to the claimant "*in proportion to the amount awarded with respect to the amount claimed*." Furthermore, the balance, if any, would be "*forfeited and paid to the other party*". The arbitration clause specified that such condition was incorporated with a view to prevent 'frivolous claims.' The arbitration clause further barred parties from agitating issues relating to the contract before a civil court unless the same had first been decided in arbitral proceedings.

The Appellant and the Second Respondent had entered into other similar contracts, which also contained the same arbitration clause. Following the emergence of disputes, the Appellant communicated with the Second Respondent regarding the appointment of the arbitrator and waiver of the deposit requirement. On receiving no response, the Appellant made two unsuccessful attempts at challenging Clause 25(viii) by way of writ petitions before the High Court of Punjab and Haryana. Thereafter, the Appellant approached the Supreme Court against the same.

The question before the Supreme Court was whether Clause 25(viii) ought to be struck down on ground(s) that it –

- amounted to a contract of adhesion and therefore, violated Article 14 of the Indian Constitution (Art. 14);

- was arbitrary and/or discriminatory and therefore, violated Art. 14; and/or

- deters arbitration.

DECISION

The Supreme Court, at the outset observed that there exist constraints on its ability to intervene in matters of government contracts. However, it noted that it may be permissible for the Court to scrutinise the terms of an invitation to tender floated by the government, if the terms thereof are "arbitrary", "discriminatory" or "actuated by malice". The Court then proceeded to determine whether the Clause 25(viii) fell within any of these conditions.

The Court rejected the Appellant's contention that Clause 25(viii) was a contract of adhesion, holding that the transaction was commercial in nature and a presumption exists that such contracts are entered into after several rounds of negotiations, with the involvement of experts. In doing so, the Court distinguished the present case as not falling within the scope of the judgment in *Central Inland Water Transport Corporation v Brojo Nath Ganguly*, (1986) 3 SCC 156.

The Court then considered the effect of Clause 25(viii) on the ability of the parties to settle their disputes through arbitration.

The Court, while noting that the aim of Clause 25(viii) was to deter frivolous claims, observed that the clause is arbitrary in the sense of being unfair and unjust and that no reasonable person would agree to the same. The Court further noted that not every claim is necessarily frivolous. A claim may be dismissed or allowed on merits and not because it is frivolous. The Court observed that in case a claim is found to be frivolous, it is always open for an arbitrator to dismiss the claim with exemplary costs.

The Court also concluded that Clause 25(viii) was arbitrary, excessive and unjust because it could potentially result in a situation where despite an award against it, the party who has lost would be entitled to forfeit such part of the deposit as falls proportionately short of the amount awarded as compared to the sum claimed.

Finally, after noting that arbitration is an important alternate dispute resolution mechanism, the Court held that the requirement of a pre-deposit, as contained in Clause 25(viii) would discourage arbitration – contrary to the object of de-clogging the Court system.

For these reasons, the Court struck down Clause 25(viii).

COMMENTS

By this judgment, the Supreme Court has indicated that while pre-arbitral deposit requirements are not invalid *per se*, such pre-conditions to initiation of arbitration cannot be disproportionate and/or burdensome so as to make arbitration a less viable dispute resolution mechanism vis-à-vis litigation in Courts.

Further, even as the Supreme Court acknowledged that frivolous claims are a significant concern, it clearly indicated that measures for deterring such claims cannot override the basic features of arbitration, namely – "*fair, speedy and inexpensive trial by an Arbitral Tribunal*".

The present judgment was passed in the context of a contract between a state instrumentality and a private party. The Supreme Court, in substance, held that Clause 25(viii) was arbitrary and, as such, in violation of Art. 14. A question that emerges from the Supreme Court's decision is – what would be the effect of such a clause in a contract between two private parties? Two private parties litigating against each other cannot

invoke the provisions of Art. 14. Perhaps, one could argue that such a clause is contrary to India's evolving public policy on encouraging arbitration and de-clogging the Court system and, therefore, void and unenforceable in view of the provisions of Section 23 of the Indian Contract Act, 1872.

The Supreme Court's decision in this case is yet another example of a systematic and progressive shift in favour of arbitration as a means to resolve disputes.

- *Kingshuk Banerjee (Partner), Radhika Gupta (Associate) and Preeti Sahai (Associate)*

For any queries please contact: editors@khaitanco.com

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Mumbai
One Indiabulls Centre, 13th Floor
Tower 1 841, Senapati Bapat Marg
Mumbai 400 013, India

T: +91 22 6636 5000
E: mumbai@khaitanco.com

New Delhi
Ashoka Estate, 12th Floor
24 Barakhamba Road
New Delhi 110 001, India

T: +91 11 4151 5454
E: delhi@khaitanco.com

Bengaluru
Simal, 2nd Floor
7/1, Ulsoor Road
Bengaluru 560 042, India

T: +91 80 4339 7000
E: bengaluru@khaitanco.com

Kolkata
Emerald House
1 B Old Post Office Street
Kolkata 700 001, India

T: +91 33 2248 7000
E: kolkata@khaitanco.com