LITIGATION NEWSLETTER

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Co-authored by:

AKS PARTNERS
Advocates | Solicitors | Consultants

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TRICKS, TRAP AND TIPS FOR DRAFTING OF AN ARBITRATION AGREEMENT

In today's time, a contract forms the basis of any commercial relationship. As the parties run a frequent risk of having disagreements that may lead to disputes, therefore, it is important for the parties to have a well-defined dispute resolution clause included in the contract. In case the parties have agreed to resolve their disputes through arbitration, they should be mindful of the contents of the arbitration clause since unclear or ambiguous terms tend to become a subject matter of prolonged litigation.

Though many arbitral institutions do provide samples of model arbitration clauses, however, it is never recommended to cut-copy-paste any arbitration clause into one's contract. The parties are, therefore, advised to comprehend the essential elements of an arbitration clause before finalizing an arbitration agreement.

In this article, we provide a brief guide to these essentials of an arbitration agreement so as to enable the effective drafting of an arbitration agreement. To this end, let's first understand the essentials of a valid arbitration agreement.

What constitutes an arbitration agreement?

The definition of an "*arbitration agreement*" has been provided under Section 7 of the Arbitration and Conciliation Act, 1992 ("**the Arbitration Act**") as

> "*an agreement by the parties to submit to arbitration all or certain disputes which have arisen, or which may arise between them in respect of a defined legal relationship, whether contractual or not.*"

ABOUT THE FIRM

AKS Partners (formerly known as A.K. Singh & Co) is a law firm based in New Delhi (India) that provides a comprehensive range of legal services and solutions to domestic and international clients. The Firm offers a unique blend of the local knowledge to apply the regulatory, economic, political and cultural context to legal issues and develop case strategies.

We regularly handle technically challenging and complex multi-jurisdictional matters. Our team is spearheaded by one of the highly recognised lawyers with extensive experience in international dispute resolution and strong government and diplomatic backgrounds. This experience gives us the deepest understanding of the key decision points that are critical in navigating complex & complicated matters and managing government regulations.

As observed by the Supreme Court of India in ***Bihar State Mineral Development Corpn. v. Encon Builders***[1] the essentials of an arbitration agreement are as follows:

> *"(1) There must be a present or a future difference in connection with some contemplated affair.*
>
> *(2) There must be the intention of the parties to settle such difference by a private tribunal.*
>
> *(3) The parties must agree in writing to be bound by the decision of such tribunal.*
>
> *(4) The parties must be ad idem."*

Intention of the parties to arbitrate.

The most essential ingredient of a valid arbitration agreement is the consensus/intention of the parties to refer the dispute to arbitration. This intention to resolve disputes through arbitration is gathered by the courts from the terms of the arbitration agreement. Therefore, the parties should be prudent of the words used for drafting an arbitration agreement and should in clear and imperative language reflect their definite decision to refer disputes to arbitration, as and when they arise. To this end, the decision of the Supreme Court in ***Jagdish Chander v. Ramesh Chander & Ors.***[2]**,** is noteworthy wherein the Apex Court while deciding a petition under Section 11 of the Arbitration Act, came across an arbitration clause which provided that in case of a dispute the same '*shall be referred for arbitration if the parties so determine*'. The Supreme Court refused to consider such a clause as an arbitration agreement and observed that -

> "*8……. mere use of the word 'arbitration' or 'arbitrator' in a clause will not make it an arbitration agreement, if it requires or contemplates a further or fresh consent of the parties for reference to arbitration ….. Such clauses require the parties to arrive at a further agreement to go to arbitration, as and when the disputes arise. Any agreement or clause in an agreement requiring or contemplating a further consent or consensus before a reference to arbitration, is not an arbitration agreement, but an agreement to enter into an arbitration agreement in future.*

[1] **(2003) 7 SCC 418**
[2] **(2007) 5 SCC 719**

9….. Therefore, when clause 16 uses the words "the dispute shall be referred for arbitration if the parties so determine", it means that it is not an arbitration agreement but a provision which enables arbitration only if the parties mutually decide after due consideration as to whether the disputes should be referred to arbitration or not. In effect, the clause requires the consent of parties before the disputes can be referred to arbitration. The main attribute of an arbitration agreement, namely, consensus ad idem to refer the disputes to arbitration is missing in clause 16 relating to settlement of disputes."

Arbitration agreement to be in writing

Section 7 (3) of the Arbitration Act prescribes that an arbitration agreement should be in writing. However, it is not mandatory that the arbitration agreement is to be contained as a clause in the mother contract. An arbitration agreement may also be in the form of a separate contract or contained in telecommunications exchanged between the parties.

A question thus arises: Can an arbitration clause contained in an independent document, be incorporated into the contract by reference? The Supreme Court of India answered this issue in the positive while deciding the case of ***M.R. Engineers & Contractors Pvt. Ltd. v. Som Datt Builders Ltd.[3], by holding that:***

"*The scope and intent of Section 7(5) may therefore be summarised thus: (i) An arbitration Clause in another document, would get incorporated into a contract by reference, if the following conditions are fulfilled: (1) The contract should contain a clear reference to the documents containing arbitration clause, (2) the reference to the other document should clearly indicate an intention to incorporate the arbitration Clause into the contract, (3) The arbitration Clause should be appropriate, that is capable of application in respect of disputes under the contract and should not be repugnant to any term of the contract.*

(ii) When the parties enter into a contract, making a general reference to another contract, such general reference would not have the effect of incorporating the arbitration Clause from the referred document into the contract between the parties."

[3] **(2009) 7 SCC 696**

Furthermore, whenever parties decide to put to an end a contract with a subsequent new contract, then as a matter of caution they should include an arbitration clause in the new contract, as the courts deem that the arbitration clause in the original contract perishes with the execution of the subsequent new contract[4].

Essential elements to be set out in an arbitration agreement.

Though the Arbitration Act does not mandate the elements mentioned below to be included in the arbitration agreement, however, it is suggested that the parties should choose to set out these elements in the arbitration agreement, so as to leave limited scope for judicial intervention and ensure smooth running of arbitration proceedings -

- **Language*:*** The parties should specify the language in which the arbitral proceedings will take place, especially when it is a cross-border transaction wherein parties belonging to different countries speaking diverse languages are involved. In such cases, it is recommended that one should not presume that the proceedings will take place in English and should clearly specify the language in which the parties intend the proceedings should be conducted.

- **Appointment procedure for the arbitral tribunal:** Section 11 (2) of the Arbitration Act provides that the parties are "*free to agree on a procedure for appointing the arbitrator or arbitrators.*" That said, the parties should ensure that the arbitration procedure fits the bill of independence and impartiality of the arbitral tribunal as the Courts will not hesitate in striking off the unenforceable portion of the agreement, if it fails to satisfy the mandatory legal requirements as contained in Section 12 of the Arbitration Act read with the Fifth and Seventh Schedule. To this effect, it should be noted that the Supreme Court when confronted with an arbitration clause giving complete power to the Managing Director of a party to appoint an arbitrator[5] held such clause to be invalid. The Supreme Court further held that the element of invalidity creeps in, if any party having an interest in the outcome of the dispute, has the power to appoint the arbitrator. Thus, any clause wherein any one party to the dispute is given power to appoint an arbitrator or arbitral tribunal should be avoided.

[4] **B.L. Kashyap and Sons Ltd. v. Mist Avenue (P) Ltd., 2023 SCC OnLine Del 3518**
[5] **Perkins Eastman Architects Dpc v. HSCC (India) Ltd., AIR 2020 SC 59**

The parties may further specify the qualification of the arbitral tribunal; however, the threshold should not be set so high that it is difficult for the parties to find a qualifying arbitrator(s).

- **Seat of arbitration*:*** Significance of the seat of arbitration is that it determines the curial/procedural law for the arbitration. It also plays an important role while determining the applicable law in the arbitration proceedings. Situs is not just about where an institution is based or where the hearings will be held, but it is also about which court would have the supervisory power over the arbitration proceedings[6] and would thus grant interim measures. Thus, before specifying the seat of arbitration, parties should carefully consider how the court system operates in that jurisdiction.

- **Governing Law*:*** By governing law we refer to the law that governs the contract. In today's time, two companies of different countries may choose to execute a contract in a different country. In such cross-border transactions, the parties should without fail, specify the country whose law shall govern the contract as the Tribunal will tend to rely upon the doctrines, tests and theories of the said jurisdiction. However, in case the same has not been specified in the contract, the courts will rely on the other terms of the contract and the surrounding situations to figure out the intention of the parties with respect to the law that will govern the contract.

- **Scope of reference:** Section 7 of the Arbitration Act expressly states that the parties can submit to arbitration *"all or certain disputes which have arisen or which may arise between them"*. Thus, in case the parties do not intend to resolve all disputes through arbitration, they should clearly state that in the contract. In any event, the parties should be conscious of the fact that all disputes are not considered to be arbitrable. The Supreme Court of India[7] has observed that disputes relating to rights and liabilities which give rise to or arise out of criminal offences, matrimonial disputes, guardianship matters, insolvency and winding up matters, testamentary matters, eviction or tenancy matters and disputes *interse* between trust, trustees, and beneficiaries, cannot be settled through arbitration.

[6] Enercon (India) Limited and others v. Enercon GMBH, (2014) 5 SCC 1
[7] Booz Allen & Hamilton Inc v. SBI Home Finance Limited & Ors., (2011) 5 SCC 532 and Vimal Kishor Shah v. Jayesh Dinesh Shah, 2016 SCC OnLine SC 825

- **Administered or Ad Hoc Arbitration*:*** The parties should also specify the name of the institution whose rules the parties prefer to follow, in case a dispute arises. However, before agreeing on the name of any institution, they should examine its rules, panel of arbitrators, time taken, and average cost incurred by the parties for the completion of proceedings before the said institution. In case the parties do not intend the arbitration to be administered by any institution, then they should opt for an Ad Hoc Arbitration.

- **Multi-Tier Resolution:** At times the parties may decide to have certain pre-arbitral steps before referring the dispute to arbitration. These may be in the form of negotiation or mediation or proceedings before dispute adjudication boards. In case the parties agree on such pre-arbitral steps, then they should specify the timelines within which they contemplate the pre-arbitral steps to be completed, or else it may lead to an unavoidable delay in commencement of arbitral proceedings.

- **Stamping of the Contract:** It should be ensured that the contract containing the arbitration agreement, which is exigible to stamp duty, should be sufficiently stamped, else it shall not be considered as a valid contract under Section 2(h) of the Indian Contract Act and hence not enforceable in law[8]. Letters, telex or telegrams or other means of communication in writing that result in an arbitration agreement would also have to be properly stamped, in accordance with the Stamp Act.

Key takeaways

Though the courts have time and again taken a pro-arbitration approach, however, in order to ensure that an arbitration agreement is not invalidated when put before the court, the following key points should be ensured, which are summarized hereunder –

a. The arbitration agreement should always be in writing.

[8] **N.N. Global Mercantile Private Limited v. M/s Indo Unique Flame Ltd & Ors., 2023 SCC OnLine SC 495**

b. A cut-copy-paste method with respect to an arbitration agreement should never be adopted and it should be ensured that the arbitration agreement is in consonance with the other clauses of the contract.

c. The arbitration agreement should reflect the clear intention of the parties to refer any dispute to arbitration, as and when they arise. Parties should refrain from using vague terminology like “might”, “may” and “will be discussed” in the arbitration agreement. Rather words that make the reference to arbitration mandatory should be used so that no scope for any ambiguity is left for interpretation by either party.

d. In case the parties are agreeing to incorporate an arbitration clause contained in another document into the contract through reference, then it should be ensured that the reference of the other document should be such that it clearly indicates the intention of the parties to incorporate the arbitration clause into the contract. This should especially be followed when an original contract is put to an end by a subsequent new contract.

e. The parties are free to agree on a procedure for the appointment of an arbitrator. However, the appointment procedure should satisfy the mandatory legal requirements as contained in Section 12 of the Arbitration Act read with the Fifth and Seventh Schedule. Parties should refrain from adopting an arbitration clause giving any one party, the power to appoint an arbitrator or tribunal or resulting in appointment of a party’s own employee or associate as an arbitrator.

f. Before opting for any arbitral institution, necessary due diligence should be done as it has been observed that the cost incurred by a party, varies for different institutions and an uninformed decision as to the choice of arbitral institution may come out to be unexpectedly heavy on the pocket.

g. Without a miss, it should also be verified that the contract containing the arbitration agreement is sufficiently stamped else the courts may treat such an arbitration agreement as *non-est*.

RECENT CASE HIGHLIGHT

An arbitration award cannot be set aside on the ground of insufficiency of stamp duty paid on arbitration agreement – Delhi High Court

Recently the Delhi High Court in the case of *ARG Outlier Media Pvt. Ltd. v. HT Media Ltd.* [O.M.P. (COMM) 161/2023] vide its judgement dated 04.07.2023, while deciding a petition filed under Section 34 of the Arbitration Act, has held that though in terms of the judgment of the Supreme Court in *N.N. Global Mercantile Private Limited v. M/s Indo Unique Flame Ltd & Ors.*, the Agreement not being properly stamped, could not have been admitted in evidence, however, once having been admitted in evidence by the Arbitrator, the Award passed by relying thereon cannot be faulted on this ground. On coming across an insufficiently stamped agreement in a section 34 petition, the Court would only impound the document, however, the same shall not, in any manner, effect the enforcement or the validity of the Arbitral Award.

LITIGATION BUZZ

Mediation Bill, 2021

In order to reduce the pendency of the cases in the courts, the Rajya Sabha on 01.08.2023, passed the Mediation Bill 2021 (“Mediation Bill”). The Mediation Bill requires persons to try to settle civil or commercial disputes through mediation before approaching any court or tribunal. That said, a party may withdraw from mediation after two mediation sessions. The Mediation Bill further provides that the mediation process must be completed within 180 days, which may be extended by another 180 days by the parties.

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CONTACT US

Building No. G-16, 3rd Floor, Saket, New Delhi – 110017

T: +91-11-40522433, 40536792

F: +91- 11- 41764559

E: info@akspartners.in

W: www.akspartners.in

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