



Jus Corpus Law Journal

Open Access Law Journal – Copyright © 2024 – ISSN 2582-7820
Editor-in-Chief – Prof. (Dr.) Rhishikesh Dave; Publisher – Ayush Pandey

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Enhancing Arbitration in India: The Role of Severability and Judicial Precedents

Biswajeet Shekhar Panda^aNoopur Yadav^b

^aDr. Ram Manohar Lohiya National Law University, Lucknow, India ^bDr. Ram Manohar Lohiya National Law University, Lucknow, India

Received 25 September 2024; *Accepted* 26 October 2024; *Published* 28 October 2024

*There is no debate on the notion that one thing common throughout the democratic and non-democratic countries around the world is dispute. **Arbitration** is one such alternative to adjudication by courts and other public fora established by law, which leads to private dispute resolution before an Arbitral Tribunal. To determine **arbitrability**, it's crucial to grasp the parameters of a legitimate arbitration agreement. According to Section 7 of the Arbitration and Conciliation Act, 1996 (Arbitration Act),¹ an 'arbitration agreement' denotes a pact between parties to resolve either all or specific disputes that have arisen or might arise about a defined legal association, whether contractual or otherwise. Hereby, it is safe to infer that Arbitration is based on a contract and the parties leave the resolution of all or part of the dispute to the arbitrator or arbitral tribunal. Although the Arbitration Act does not explicitly define the term 'agreement', Section 10 of the Contract Act 1872³ stipulates that all agreements qualify as contracts provided they meet certain criteria, according to the Supreme Court's ruling in *Vidya Drolia v Durga Trading Corpn.*⁴ An arbitration agreement must fulfil the requirements outlined in Section 7 of the Arbitration Act⁵ as well as those mandated*

¹ The Arbitration and Conciliation Act 1996, s 7

² The Arbitration and Conciliation Act 1996

³ Indian Contract Act 1872, s 10

⁴ *Vidya Drolia v Durga Trading Corporation* (2021) 2 SCC 1

⁵ The Arbitration and Conciliation Act 1996, s 7

by Section 10 of the Contract Act.⁶ According to this, if an arbitration agreement fails to meet the legal standards, it is deemed **void** and lacks legal validity and hence any disputes intended for arbitration under such a contract would become non-arbitral due to the absence of a valid arbitration agreement. This means that arbitration agreements play a secondary role in the primary instrument such as contracts rendering the doctrine of **severability** and *Kompetenz- Kompetenz*, which give the power to arbitral tribunal to have a final say in these matters and allow them to sever the void part of the agreement. This brings us to our core query, i.e. if an arbitration agreement cannot function as a distinct instrument in a contract then in the case of a void contract how will the enforceability of the arbitration agreement be affected? We will be sailing through statutes, doctrines and case laws further in the article to try and resolve this milieu.

Keywords: arbitration, judicial precedents, contract, conciliation.

INTRODUCTION

The role of arbitration as a mechanism for dispute resolution is increasingly significant in India's legal landscape. In a country marked by a myriad of disputes, the ability to resolve conflicts outside the traditional court system offers both efficiency and confidentiality. The Arbitration and Conciliation Act of 1996 provides the framework for this process, yet complexities arise when considering the validity and enforceability of arbitration agreements, especially in cases where the underlying contract is declared **void**. However, the judicial interpretations surrounding this principle have been inconsistent, raising critical questions about the reliability of arbitration agreements in practice. Landmark cases such as *Kishorilal Gupta and Reva Electric Car Company Pvt Ltd* highlight the tensions between established precedents and evolving legal interpretations.

Arbitration clauses are frequently included in consumer and employment contracts, although they can also be suggested as amendments during negotiations for any type of contract, aiming to pre-emptively address the potential for future lawsuits. We understand that most of the arbitrations take place under an arbitration clause in the main contract and to determine the legal holding of the arbitration clause, it becomes quite significant to know the governing legal

⁶ Indian Contract Act 1872, s 10

framework to an arbitration clause. As the majority of arbitrations are initiated based on an arbitration clause contained within the main contract, the significance of this provision cannot be overstated. In Indian law, the principle of **severability** concerning an arbitration clause is recognised, permitting parties to designate the substantive law governing the dispute and/or the substantive law of the entire contract differently from the law governing the arbitration agreement. The substantive law of the contract governs the arbitration tribunal's decisions on disputes between the parties, while the governing law of arbitration pertains to matters concerning the arbitration agreement, such as the arbitrability of disputes. An arbitration clause, integrated within the entirety of the contract, is considered a separate agreement in its own right, distinct from the main contract and capable of surviving even if the main contract is terminated or rendered null. This principle of severability not only ensures the effectiveness of arbitration as an alternative to litigation but also establishes the groundwork for parties to opt for one legal system to govern the dispute while selecting another to govern the arbitration agreement and/or the arbitration procedure. This stands codified in Section 16(1) of the Arbitration Act, 1996⁷ and is a well-established jurisprudence consistently upheld by the Apex Court. Following the dicta of various Supreme Courts and various High Courts concerning the choice and applicability of substantive and curial law, it is safe to infer that the right of parties to distinguish the arbitration clause from the underlying contract is apparent.

WHAT DOES THE PRECEDENCE SAY?

To dig a little deeper into this, we need to dive into the legal arena of case laws, which have held the normative and the positive positions. The posited position in India remains the positive legal position given for the first time in the Kishorilal Gupta case.⁸ In this case, one of the two issues was whether the original proceedings arising out of the arbitration agreement resulted in nullity since there had been a breach of the original agreement and the entirety of the contract was declared void. The learned judges of the Supreme Court relying on *Heyman v Darwins*⁹ held that when the underlying contract is void ab initio, the arbitration clause cannot operate on those

⁷ The Arbitration and Conciliation Act 1996, s 16(1)

⁸ *Union of India v Kishorilal Gupta & Bros* (1959) SCC OnLine SC 6

⁹ *Heyman v Darwins Ltd*, [1942] UKHL J0220-1

disputes, for its operative force depends upon the existence and validity of the contract. It was held that when the underlying contract is void ab initio, the survival of the arbitration clause is implausible. This is because it would involve arbitrating the rights and liabilities of the parties to an agreement out of which no such rights and liabilities could ever flow. The reasoning of the court followed that if a contract is illegal and void, an arbitration clause, which is one of the terms thereof, must also perish along with it. The arbitration clause, being an integral part of the contract, cannot stand if the contract itself is held to be illegal. It is difficult to conceive how, when a contract is found to be bad, any portion of it can be held to be good. When the whole perishes, its parts must also perish. This is defined in the Latin maxim- 'Ex nihilo nil fit'. On principle, therefore, it must be held that when a contract is invalid, every part of it, including the clause as to arbitration contained therein, must also be invalid. That is also the view taken by this Court in other key precedents such as *Khardah Company Ltd. v Raymon & Co. (India) Pvt. Ltd.*¹⁰ and *Waverly Jute Mills Co. Ltd. v Raymon & Co. (India) Pvt. Ltd.*¹¹ The jurisprudence in India relies upon the judgment of *Hayman v Darwis*¹² which supports the legal stance that if the contract is void ab initio, then the arbitration agreement stands negated.

However, it becomes pertinent to note that the English judgment of *Heyman v Darwis*, which was held by the UK Court of Appeal, was overturned in *Fiona Trust & Holding Corporation v Yuri Privalov*,¹³ which declared that the arbitration agreement would not be affected due to the contract being void and the final decision would be of the arbitrator. Furthermore, an inconsistency in the *Kishorilal Gupta case* approach has been observed since the Supreme Court of India adopted a different stance in 2011 in *Reva Electric Car Company Pvt Ltd v Green Mobil*,¹⁴ which has also found subsequent reaffirmation in *Ashapura Mine-Chem Ltd v Gujarat Mineral Development Corporation*¹⁵ in which the court held that an arbitration clause shall be treated as an agreement independent of the other terms of the contract and the contract being void shall not entail *ipso jure* the invalidity of the arbitration clause. This view was further recognised in the

¹⁰ *Khardah Co Ltd v Raymon & Co Ltd* 1962 SCC OnLine SC 28

¹¹ *Waverly Jute Mills Co Ltd v Raymon & Co Private Ltd* (1963) AIR 90

¹² *Heyman v Darwins Ltd* 1942 AC 356

¹³ *Fiona Trust & Holding Corporation v Yuri Privalov* [2007] EWCA Civ 20

¹⁴ *Reva Electric Car Co Ltd. v Green Mobil* (2012) 2 SCC 93

¹⁵ *Ashapura Mine-Chem Ltd v Gujarat Mineral Development Corpn* (2015) 8 SCC 193

*N.N.Global Mercantile*¹⁶ case, where the court settled on the view that on the application of the Doctrine of **Kompetenz-Kompetenz** enshrined in Section 16 of the Act, the Arbitral Tribunal may rule on its jurisdiction including objection relating to the validity of the Arbitration Agreement and its very existence. Equally, it was recognised under Section 16(1)(b)¹⁷ that despite the Tribunal finding that the contract was null and void, it would not invalidate the Arbitration Clause.

Furthermore, the judgment of the Kishorilal case was given before the enactment of the Arbitration and Conciliation Act 1996, under which the Principle of Severability came into existence. Under Section 16(1) of the Act,¹⁸ the severability of the clause is mentioned, which mentions that the arbitration clause which forms a part of the contract shall be treated as an agreement independent of the other terms of the contract. This has been recognised under Article 16(1) of the UNCITRAL Model law of 1985 on international commercial arbitration.

This doctrine has been recognised in the Supreme Court in the case of *National Agricultural Coop. Mktg. Federation of India Ltd. V Gains Trading Ltd.*,¹⁹ where the learned judges have stated that the arbitration clause is collateral in the contract, which relates to resolving disputes and not to the specific performance of the contract. Therefore, even if the performance of the contract comes to an end on account of termination, **frustration** or breach of contract, the arbitration agreement would survive the termination.

It is apparent in the shadow of the words cited that the court respected the autonomy of an arbitration clause and rather than rendering the instrument altogether invalid, the focus should be on speedy resolution of the dispute in the light of basic doctrines that uphold the arbitration agreement.

¹⁶ *N.N. Global Mercantile (P) Ltd. v Indo Unique Flame Ltd.* (2021) 4 SCC 379

¹⁷ The Arbitration and Conciliation Act 1996, s 16(1)(b)

¹⁸ The Arbitration and Conciliation Act 1996, s 16(1)

¹⁹ *National Agricultural Coop. Marketing Federation India Ltd. v Gains Trading Ltd.* (2007) 5 SCC 692

RETHINKING NORMATIVE PRINCIPLES IN ARBITRATION

In this context, it becomes pertinent to ask why the **normative** position arises as a better alternative to the positive position. Firstly, the idea that no rights or obligations arise from a void agreement from the beginning is not entirely true. One example of such a right is the right against unjust enrichment. This means that if, despite the agreement being void, one party has gained an unfair advantage or benefit at the expense of the other party, the affected party still has the right to seek restitution or compensation. In essence, while the agreement itself may be void and unenforceable, certain legal protections may still apply to prevent one party from unfairly benefiting from the invalid agreement. Secondly, the Fiona Trust standard should be adopted instead of relying upon the Hayman judgment, which was overturned by the Fiona Trust judgment. It recognises that promises to arbitrate, while related, are separate from the main contract. The main contract deals with performing obligations and compensation, while the arbitration promise is simply about using arbitration to resolve disputes. Each promise is different in purpose and outcome, so the ability to make each promise should be considered separately. Lord Hoffman also pointed out in Fiona Trust that making an exception to this separation could cause problems. Parties who agreed to arbitration might change their minds and prefer traditional litigation for short-term commercial gain.

PATHWAYS FOR LEGAL CERTAINTY

1. Adoption of International Standards: India could consider adopting international standards, such as the Fiona Trust standard, which recognises the severability of arbitration agreements from the main contract. This approach would align Indian arbitration laws with global practices and facilitate international trade and investment. By adopting this standard, India would demonstrate its commitment to providing a supportive environment for arbitration, which is crucial for attracting foreign investment and ensuring the enforceability of arbitration agreements in international contracts. Furthermore, aligning India's arbitration framework with international best practices, such as the UNCITRAL Model Law on International Commercial Arbitration, could enhance India's attractiveness as a global arbitration hub. This alignment could also simplify cross-border dispute resolution for international parties. By adopting these suggestions, India can fortify its arbitration regime, ensuring that it remains an effective,

efficient, and equitable mechanism for dispute resolution, even in the complex scenario of void contracts.

2. Consistent Judicial Precedents: The judiciary should strive for consistency in interpreting and applying laws related to arbitration agreements. Clear and consistent judicial precedents would provide parties with predictability and confidence in the arbitration process. This could involve the establishment of specialised arbitration courts or panels to ensure that arbitration cases are heard by judges with expertise in arbitration law. Additionally, regular training programs for judges on arbitration law and practices could help improve consistency in judicial decisions related to arbitration.

CONCLUSION

In conclusion, the arbitration agreement serves as a pivotal element within contracts, offering a pre-emptive mechanism for dispute resolution outside the courts. The principle of severability, enshrined in Section 16(1) of the Arbitration and Conciliation Act, 1996, and upheld by various judicial precedents, underscores the independence of the arbitration clause from the main contract. This doctrine ensures that the arbitration agreement remains valid and enforceable even if the main contract is void, fostering an environment conducive to swift and efficient dispute resolution. However, the evolution of judicial interpretations, from the Kishorilal Gupta case to more recent rulings, highlights the dynamic nature of arbitration jurisprudence in India. The shift towards recognising the arbitration clause as an independent agreement, as seen in cases like Reva Electric Car Company Pvt Ltd and Ashapura Mine-Chem Ltd, aligns with international standards and enhances the efficacy of arbitration as a dispute resolution mechanism.

Adopting international standards, such as the Fiona Trust standard, and ensuring consistent judicial precedents will fortify India's arbitration regime. This alignment with global practices will not only attract foreign investment but also reinforce the credibility and reliability of arbitration agreements in India. By embracing these measures, India can solidify its position as a global arbitration hub, providing an effective, efficient, and equitable platform for resolving disputes, even in the context of void contracts.