

The Supreme Court sets aside Order appointing an Arbitrator & expounds on the pre-referral jurisdiction of the High Court under Section 11 of the Arbitration and Conciliation Act, 1996 as amended

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On 10th April 2023, the Supreme Court of India pronounced its judgment in the case of **NTPC Ltd. vs M/s SPML Infra Ltd. Civil Appeal No. 4778 of 2022** (“**NTPC vs SPML**”), expounding on the jurisdiction of the High Court on deciding an application under Section 11 of the Arbitration and Conciliation Act, 1996 as amended (“**Arbitration Act**”) for appointment of an arbitrator. The Supreme Court of India set aside the impugned order of the Delhi High Court appointing an arbitrator and directing the constitution of an arbitral tribunal and reiterated that the High Courts are not expected to *act mechanically merely to deliver a purported dispute raised by an applicant at the doors of the chosen arbitrator (DLF Home Developers Limited v. Rajapura Homes Pvt. Ltd, 2021 SCC OnLine SC 781)*. This decision gains significance in the backdrop of Section 11(6)(A) of the Arbitration Act, which confines the scope of a court seized with an application for the appointment of an arbitrator to the examination of the existence of an arbitration agreement. The said Section 11(6)(A) has been omitted by Act 33 of 2019 but the relevant section of Act 33 of 2019 omitting Section 11(6)(A) has not been notified till date. Thus, as a result, Section 11(6)(A) continues to remain in force.

Brief Facts:

1. The NTPC and SPML entered into a contract for the installation of a piping package at the NTPC Thermal Power Project at Simhadri, Visakhapatnam. Pursuant to the terms of the contract, SPML furnished Performance Bank Guarantees and Advanced Bank Guarantees to secure NTPC.
2. On the completion of the contracted work, SPML issued a No-Demand Certificate and NTPC released the final payment due. NTPC however withheld the Bank Guarantees on account of pending liabilities and disputes pertaining to other projects. SPML protested the retention of the Bank Guarantees even after the Completion Certificate and No-Demand Certificate was issued and unjustifiably linking the retention to other projects. Following the protest, SPML went on to raise a demand of approx. INR 72 Lakhs from NTPC as liabilities recoverable for actions attributable to NTPC under the contract.
3. SPML subsequently called upon NTPC to appoint an Adjudicator for resolving pending disputes per the conditions of the contract. After there was no response from NTPC on the same, SPML moved the Delhi Court by filing a Writ Petition under Article 226 of the Constitution of India praying for the quashing of an email issued by NTPC pertaining to the Bank Guarantees and to direct NTPC to release the same.

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While issuing notice, the Delhi High Court passed an Interim Order directing NTPC to not encash the Bank Guarantees and SPML to keep the same alive. SPML however, allowed the Bank Guarantees to expire inspite of the Interim Order.

4. Pending the Writ proceedings, the parties entered into a Settlement Agreement wherein NTPC agreed to release the Bank Guarantees and SPML agreed to withdraw the Writ Petition and to not initiate any other proceedings including arbitration under the contract. NTPC released the Bank guarantees per the agreed terms. Two months later, SPML issued a letter of repudiation of the settlement agreement and subsequently withdrew the Writ Petition.

5. Following the settlement of disputes and its implementation, SPML repudiated the Settlement Agreement and filed the Application under Section 11(6) of the Arbitration Act before the Delhi High Court alleging coercion and economic duress in the execution of the Settlement Agreement.

Decision of the High Court:

The Delhi High Court allowed the SPML's Application under Section 11, referring to multiple previous decisions of the Supreme Court and examining two points of contention within the averments being:

Firstly, it rejected NTPC's challenge that SPML ought to have utilized the alternative dispute resolution mechanism under the contract and recorded that SPML indeed had made such a request which NTPC had rejected.

Secondly, it did not accept that the dispute in question "whether the contract stood discharged in terms with the settlement agreement", is ex-facie untenable, insubstantial or frivolous.

Law as crystalized in NTPC vs SPML:

The Supreme Court referring to a number of its previous judgments, namely, *Vidya Drolia and Ors. v. Durga Trading Corporation*, (2021) 2 SCC 1, *Duro Felguera, S.A. v. Gangavaram Port Ltd.*, (2017) 9 SCC 729, *United India Insurance Co. Ltd. v. Antique Art Exports Pvt. Ltd.*, (2019) 5 SCC 362, *Pravin Electricals Pvt. Ltd. v. Galaxy Infra and Engg. Pvt. Ltd.*, (2021) 5 SCC 671, *Indian Oil Corporation Ltd. v. NCC Ltd.*, (2022) SCC OnLine SC 896, enumerated on the limited scope of judicial scrutiny at the pre-referral stage under Section 11 that was brought through the 2015 Amendments to the Arbitration Act, namely Section 11(6)(A) of the Arbitration Act.

The overarching principle with respect to pre-referral jurisdiction was laid down in *Vidya Drolia* wherein "the existence of an arbitration agreement" would include its validity as well which may be scrutinized strictly through the "*prima facie review*" test. The general rule and principle is that the arbitral tribunal is the preferred first authority to determine all questions of jurisdiction and non-arbitrability.



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The exception to this general rule is that the Court may reject claims which are manifestly and *ex-facie* non-arbitrable. The standard of scrutiny for the Court to examine non-arbitrability however is only *prima facie* which includes the need for the Courts to examine whether the assertion on arbitrability is *bona fide* or not.

While the limited scrutiny of the Court is necessary, it is intertwined with the duty of the Court to “*protect the parties from being forced to arbitrate when the matter is demonstrably non-arbitrable*”.

Court’s Ruling:

The Supreme Court applied the aforementioned principles basis the *prima facie* review of the facts of the case. Basis a simple narration of the facts, the Court concluded that the allegations of coercion and duress were not *bona fide* and that there were no pending claims between the parties for submissions to arbitration which was held to be an afterthought. The Supreme Court arrived at the aforementioned conclusions on the basis of two *prima facie* factual points:

1) The Settlement Agreement in question was executed while the Writ proceedings were ongoing and SPML had the protection of an Interim Order with terms that NTPC would not file contempt proceedings against SPML and that SPML would not initiate any proceedings including arbitration under the contract. Consequently, the Settlement Agreement entered with NTPC resulted in NTPC returning the Bank Guarantees. The Settlement Agreement recorded that there were no subsisting issues pending between the parties.

2) Two months *after* the release of the Bank Guarantees, the letter of repudiation was issued by SPML and the Writ Petition withdrawn after reaping the benefits of the Settlement Agreement post which the Section 11(6) Application came to be filed. The Supreme Court concluded that the letter of repudiation was only issued by SPML to wiggle out of the terms of the Settlement Agreement.

The Supreme Court of India held that the High Court should have exercised the *prima facie* test and should have exercised restricted and limited review as envisaged in law and should have protected the parties from being forced to arbitrate. The apex court held that the High Court ought to have examined the issue of the final settlement of disputes in the context of the principles laid down in *Vidya Drolia*.



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Conclusion/ Ramifications:

The judgment reiterates the position it has taken earlier that if the duty to protect parties from being forced to arbitrate, when the matter is demonstrably non-arbitrable, is not exercised within the limited compass “and the Court becomes too reluctant to intervene, it may undermine the effectiveness of both, arbitration and the Court”.

The instant judgment places an inherent duty on the High Courts to actively apply the principles laid down in *Vidya Drolia*, putting together the limited scrutiny with the *prima facie* test and the duty to protect parties being forced to arbitrate together and not merely be mechanical in their approach to their pre-referral jurisdiction.

The current judgment would be the opening act in proceedings with High Courts related to applications under Section 11 of the Arbitration Act as it would immediately trigger the *prima facie* test basis the arbitrability. Further, it would then come down to the facts of each case whether the exemption to competence-competence would apply, however, it may be considered that the chances of the exception being applied may have just gone up with Courts being addressed to actively adjudicate, albeit in a limited capacity.



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