

Dispute Resolution Hotline

September 23, 2011

FATE OF ARBITRATION CLAUSE IN UNREGISTERED AGREEMENT WITH IMPROPER STAMP DUTY

INTRODUCTION

The Supreme Court ("SC") in the case of *M/s. SMS Tea Estates Pvt. Ltd. ("Appellant") vs. M/s. Chandmari Tea Co. Pvt. Ltd. ("Respondent")*¹ held that under the provisions of Registration Act, 1908 ("Registration Act") an arbitration clause can remain enforceable in certain situations even if it forms part of an unregistered (but compulsorily registrable) document. But the agreement including the arbitration clause will not be admissible as evidence in court prior to payment of deficit stamp duty and penalty as per Stamp Act, 1899 ("Stamp Act").

FACTS OF THE CASE

In the present case, the Appellant had alleged that the Respondent had agreed to sell two tea estates for a consideration of INR 40 million. But later, the parties entered into a lease agreement ("Lease Deed") dated December 21, 2006, wherein the Appellant was granted a lease of 30 years with regard to the said two tea estates.

The Respondent abruptly evicted the Appellant from the said two tea estates and took over their management in January, 2008 leading to disputes between the parties. Thereafter, the Appellant invoked arbitration clause as per the terms of the Lease Deed and claimed for either sale of estates/possession for 30 year period as per terms of the Lease Deed/refunds of the amount invested in the tea estates. The Respondent objected to the appointment of the Arbitrator on the ground that the arbitration clause, contained in an unregistered (but compulsorily registrable) document, is invalid and unenforceable.

The High Court of Guwahati dismissed the arbitration application stating that arbitration clause in an unregistered Lease Deed does not form part of a collateral transaction and thereby is invalid and unenforceable, leading to the present appeal before the SC.

KEY ISSUES

The SC framed three major issues for consideration:-

Issue 1: Whether an arbitration agreement contained in an unregistered (but compulsorily registrable) instrument is valid and enforceable?

Issue 2: Whether an arbitration agreement in an unregistered instrument which is not duly stamped, is valid and enforceable?

Issue 3: Whether there is an arbitration agreement between the appellant and respondent and whether an Arbitrator should be appointed?

ANALYSIS

Validity and Enforceability of arbitration clause as part of unregistered agreement (but compulsorily registrable)

It is settled law that documents which are to be registered compulsorily, if not registered as required under the provisions of the Registration Act do not affect the immovable property therein, and the same may not be admissible as evidence in transactions affecting such property,² except for two limited purposes. Firstly as evidence of a contract in a suit for specific performance and secondly as evidence of any collateral transaction which by itself is not required to be effected by registered instrument.

The question is whether a provision for arbitration in such an unregistered document is a collateral transaction, in respect of which such unregistered document can be received as evidence under the proviso to Section 49 of the Act. The SC held that arbitration clause in an agreement is independent of the other terms of the contract and not compulsorily registrable under the Registration Act. The arbitration agreement survives even after the termination/breach of the main contract.

It was held that in the present case, two documents one affecting immovable property requiring registration and other relating to resolution of disputes, not compulsorily registrable were clubbed together. The SC relying on the provisions of Section 16 of the Arbitration and Conciliation Act, 1996³ ("Arbitration Act") held that arbitration agreements remain unaffected arising out of unregistered deeds of immovable property. However, the SC carved out an exception and held that arbitration agreements would also be rendered invalid in case of agreements voidable at the option of one party. The SC on a conjoint reading of Section 16 of the Arbitration Act and Section 49 of the Registration Act held the arbitration clause to be valid and enforceable.

Applicability of Stamp Act to arbitration clauses as part of unduly stamped agreements

Upon review of the provisions of the Stamp Act, the SC held that instruments unduly stamped are not admissible as evidence even in collateral transactions unless deficient stamp duty or penalty is paid. . The provisions of the Stamp

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Act do not provide for any exception (as provided in case of Registration Act), permitting admissibility of unduly stamped documents for evidence purposes. In such cases, at the very outset the Courts are entrusted with the duty to examine documents from stamp duty perspective and impound unduly stamped documents. The arbitration agreement contained in an unregistered and unduly stamped Lease Deed will be invalid and unenforceable prior to payment of deficit duty and penalty as per Stamp Act.

Existence of Arbitration Agreement and Appointment of Arbitrator

The SC after analyzing the above two issues held that as arbitration agreement could be delinked in the present case, it was valid and enforceable and Arbitrator could be appointed as per Section 11 of the Arbitration Act for the purpose of resolving disputes. However, the Lease Deed being unregistered, the terms cannot be relied upon to claim or enforce any right in respect of the property therein. In the present case, the Appellant had sought relief by enforcement of alleged agreement of sale of two tea estates/enforcing lease for thirty years and recovery of amounts spent in the tea estates.

1. As the alleged agreement of sale is entered prior to the Lease Deed being affected, the arbitration clause is inapplicable. As the arbitration agreement is not wide and does not provide for arbitration in regard to all disputes but only for settlement of disputes arising in relation to the lease deed, the arbitration clause though available is of little assistance. Thus, in the present case, the Arbitrator will not be able to grant any relief with regard to the agreement of sale, be it performance or for damages.
2. Further, the Arbitrator cannot entertain any claims for enforcement of the Lease Deed as the Lease Deed was not registered and cannot affect the immovable property therein nor be received as evidence of any transaction affecting such property.
3. With regard to the recovery of the amounts spent by the Appellant, no relief can be granted by the Arbitrator. The SC held that if recovery of the amount is treated de hors the Lease Deed, the Arbitrator may not have the jurisdiction to decide such disputes and if treated as claim for damages for breach of the terms of the Lease Deed, the same would lead to enforcement of terms of the Lease Deed, which is not permissible in the present case.

Considering the above facts and analysis, SC returned the matter back to the High Court of Guwahati, for deciding the issue of stamp duty and appointing an Arbitrator, once the agreement is duly stamped.

DECISION AND RATIONALE

The SC analyzing the above three issues prescribed the procedure to be adopted for examining the validity and enforceability of arbitration clauses contained in unregistered (but compulsorily registrable) and not duly stamped agreements:-

1. Any document to be admitted as evidence needs to satisfy two criteria prior to admission- whether it is duly stamped and whether compulsorily registrable.
2. First Stage- If the said document is unduly stamped; the same may be impounded by Court/Arbitrator as per the provisions of the Stamp Act and will not be admissible as evidence. In the event of deficit or penalty being paid to cure the defect of stamping, the Courts may treat the document as duly stamped.
3. Second Stage- If the document does not require compulsory registration, arbitration can proceed. On the other hand, if the document is compulsorily registrable under the Act, placing reliance on the provisions of Section 16 of the Arbitration Act, both the parts may be segregated though the main agreement affecting the property may not be admissible as evidence. Objections to the validity of the arbitration agreement are tenable under law provided it falls under the exception mentioned above.
4. After delinking the agreement, if the arbitration agreement is valid and enforceable the same may provide relief only to the extent of suits seeking specific performance or for collateral transactions, not requiring registration.

- Payel Chatterjee, Vyapak Desai & Vivek Kathpalia

¹ Civil Appeal No. 5820 of 2011 arising out of SLP No. 24484/2010

² Section 49-Effect of non-registration of documents required to be registered

No document required by Section 17 (1) [or by any provisions of the Transfer of Property Act, 1882 (4 of 1882)] to be registered shall--

(a) affect any immovable property comprised therein or

(b) confer any power to adopt, or

(c) be received as evidence of any transaction affecting such property or conferring such power, unless it has been registered: [Provided that an unregistered document affecting immovable property and required by this act or the transfer of Property Act, 1882 (4 of 1882), to be registered may be received as evidence of a contract in suit for specific performance under Chapter II of the Specific Relief Act, 1877 (1 of 1877), or as evidence of part performance of a contract for the purposes of section 53A of the Transfer of Property Act, 1882 (4 of 1882), or as evidence of any collateral transaction not required to be effected by registered instrument.]

3 Section 16- Competence of arbitral tribunal to rule on its jurisdiction

1) The arbitral tribunal may rule on its own jurisdiction, including ruling on any objections with respect to the existence or validity of the arbitration agreement, and for that purpose,—

(a) an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract; and

(b) a decision by the arbitral tribunal that the contract is null and void shall not entail *ipso jure* the invalidity of the

arbitration clause.

- (2) A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than the submission of the statement of defence; however, a party shall not be precluded from raising such a plea merely because that he has appointed, or participated in the appointment of, an arbitrator.
- (3) A plea that the arbitral tribunal is exceeding the scope of its authority shall be raised as soon as the matter alleged to be beyond the scope of its authority is raised during the arbitral proceedings.
- (4) The arbitral tribunal may, in either of the cases referred to in sub-section (2) or sub-section (3), admit a later plea if it considers the delay justified.
- (5) The arbitral tribunal shall decide on a plea referred to in sub-section (2) or sub-section (3) and, where the arbitral tribunal takes a decision rejecting the plea, continue with the arbitral proceedings and make an arbitral award.
- (6) A party aggrieved by such an arbitral award may make an application for setting aside such an arbitral award in accordance with section 34.

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