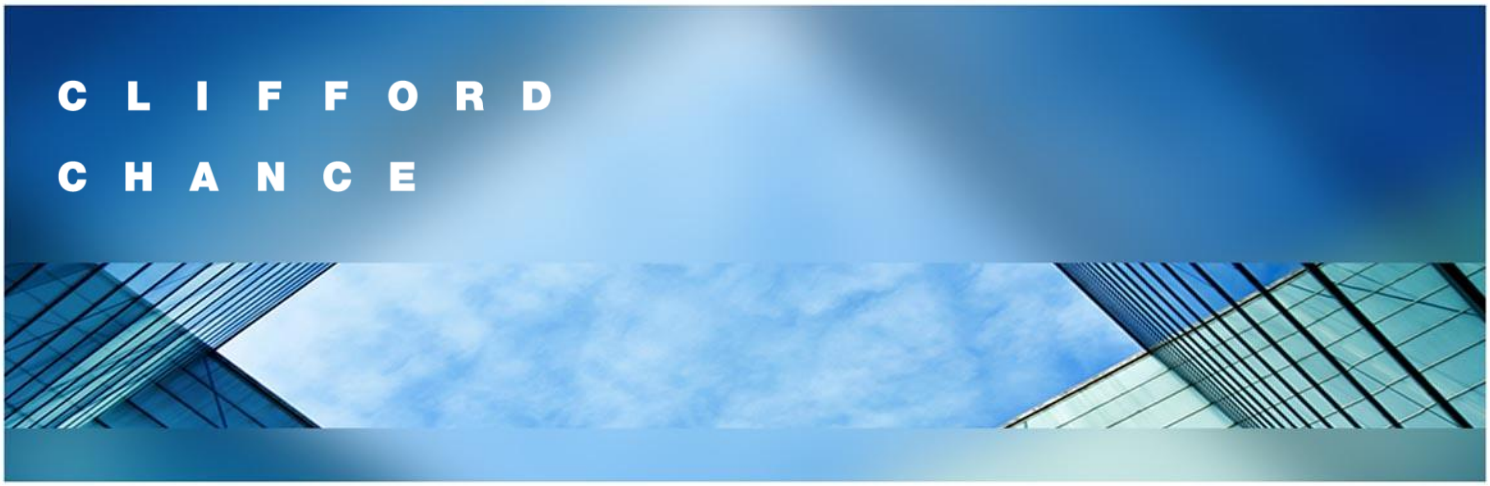

INDIAN ARBITRATION – ONE STEP FORWARD, ONE STEP BACK

Over the past decade, India has sought to revitalise its commercial dispute resolution landscape. In particular, it has promoted arbitration as an alternative to litigation through legislative reform, the establishment of reputable arbitration institutions and fostering a pro-arbitration culture. Yet along with substantial progress, there is a continued tendency for the courts to issue decisions which threaten to act as roadblocks on the path to India's desired status as an arbitration hub.

In this briefing, we consider two recent decisions which are illustrative, in turn, of the progress and periodic setbacks before the courts. In the first, the Delhi High Court endorsed the role of third-party funders in a healthy dispute resolution ecosystem by facilitating access to justice for impecunious parties with meritorious claims. In the second, the Supreme Court ruled that an arbitration agreement contained in an instrument which is not duly stamped is "non-existent in law," a decision which threatens to make arbitration proceedings vulnerable to intervention by the Indian courts and provide a headache for arbitral institutions.

DELHI HIGH COURT ENDORSES THE USE OF THIRD-PARTY FUNDING

In *Tomorrow Sales Agency Private Limited v. SBS Holdings, Inc. and Ors.* (2023 DHC 3830), the Delhi High Court acknowledged the importance of third-party funding to commercial dispute resolution, observing that it is "essential to ensure access to justice." In comments generally in line with prevailing international trends, the court recognised the benefits of third-party funding mechanisms for claimants who may lack the resources necessary to pursue claims in arbitration and remarked that "[i]n absence of third-party funding, a person having a valid claim would be unable to pursue the same for recovery of amounts that may be legitimately due." Previously, there had only been limited Indian judicial precedent on the permissibility of third-party funding in the modern context.

Key issues

- Considerable efforts have been made to improve the efficiency and reliability of Indian arbitration proceedings, through legislative reform and a push towards institutional arbitration. Nonetheless, there remains a tendency for periodic setbacks before the Indian courts.
- In a positive development, the Delhi High Court has endorsed third-party funding as "playing a vital role in ensuring access to justice." The decision will provide reassurance to funders and funded parties that third-party funding is accepted in the Indian legal market.
- In a backwards step, a Supreme Court ruling that an arbitration agreement contained in an instrument which is not duly stamped cannot be acted upon creates the potential for delays and disruption to arbitration proceedings involving Indian parties.
- The recommended dispute resolution mechanism for foreign investors involved with India-related transactions remains foreign-seated arbitration.

The question before the Court was whether a third-party funder which had funded claims brought in arbitration proceedings, but which was not in fact party to the arbitral proceedings or the award, could be made to bear the costs awarded against a claimant.

In the underlying dispute, the Claimants (an Indian logistics company and its promoters) had brought SIAC arbitration proceedings against their business partners SBS Holdings Inc. (SBS). The Claimants contended that SBS had committed contractual breaches and engaged in conduct which had caused financial distress to the joint business, and pursued their claims in arbitration at the Singapore International Arbitration Centre (SIAC).

Tomorrow Sales Agency Private Limited (TSA), a non-banking financial company, had agreed to provide financial assistance to the Claimants for the purposes of pursuing their claims for damages in the amount of approximately INR 250 crores (US$48 million) and entered into a Bespoke Funding Agreement (BFA) with the Claimants which governed the terms of that arrangement. However, the Claimants were unsuccessful in their claim and were ordered by the Tribunal to pay SBS over US$1 million in costs. SBS was unable to enforce the costs award against the Claimants and thus sought to recover payment of the costs award from TSA, filing an application under Section 9 of the Indian Arbitration and Conciliation Act (the Arbitration Act) seeking interim measures against TSA to secure the amount awarded in its favour.

SBS argued (among other things) that TSA had not merely funded the arbitral proceedings but had "*substantially controlled it*" and had "*funded the arbitral proceedings for its own benefit*" in the hope that Claimant would be successful. TSA was a "*real party to the arbitral proceedings*" and should be made to bear the costs award. It also contended that jurisprudence should be evolved by which third-party funders can, as a matter of principle, be held accountable for funding impecunious persons if they are unsuccessful.

TSA denied that it had any obligation to pay the costs. Since the Claimants were unsuccessful, the BFA stood terminated on the date of the arbitral award and TSA had no continuing obligations thereafter.

The Single Judge of the Delhi High Court had ruled in favour of SBS, ruling that "[SBS] could not be made to bear costs for the purpose of defending a litigation, which was found to be without any merit and which may not have been initiated but for being funded by a third party."

On appeal, however, a two-judge bench of the Delhi High Court overturned the decision of the Single Judge and ruled that TSA had no liability to pay any amount under the arbitral award. Among other things, the Court reasoned that:

- A third party may be bound by the arbitral award only if it has been compelled to arbitrate and is a party to the arbitration proceedings. Correspondingly, an arbitral award cannot be enforced against a third-party funder which is a non-signatory to the arbitration agreement and not a party to the arbitral proceedings.
- In this case, SBS had not taken any steps to include TSA as a party to the arbitration and had not made any attempt to secure any order against TSA, although it was fully disclosed that TSA was funding the claim on behalf of Claimants.

- The terms of the BFA between TSA and the Claimants did not provide any obligation for TSA to meet the obligations of an adverse costs award.

The Court went on to emphasise that third-party funding is "essential to ensure access to justice" and took the view that if third-party funders were held liable for adverse costs without having undertaken such liability, this would dissuade them from funding parties to dispute resolution proceedings. While the Court's analysis is sound, it is worth noting that in jurisdictions where third-party funding is more established, reputable funders do (contrasted with the terms of the BFA in *Tomorrow Sales*) frequently undertake to assume adverse costs liability in the terms of their funding agreements.

The Court also alluded to the need for third-party funding to be subject to appropriate regulation, remarking that "[i]t is also necessary to ensure that there is transparency and that the third-party funding is not exploitative." It also observed that "[t]he fact that a party is funded by a third party is a relevant fact in considering whether an order for securing the other party needs to be made."

SUPREME COURT RULES THAT AN ARBITRATION AGREEMENT IN AN UNSTAMPED DOCUMENT CANNOT BE ACTED ON

Meanwhile, in a decision which can only be viewed as a major backwards step and likely to cause considerable procedural headaches, the Indian Supreme Court in *NN Global Mercantile Limited v. Indo Unique Flame Limited and Ors* (Civil Appeal No(s). 3802-3803 of 2020) has held that an arbitration agreement would not constitute a contract enforceable under Indian law, if the instrument containing the arbitration agreement is not duly stamped.

The decision relates to an argument frequently raised in arbitrations involving contracts governed by Indian law – namely, that the tribunal does not have jurisdiction (or the contract in question is not admissible in evidence) because the arbitration agreement is contained in a contract which has not been duly stamped under the Indian Stamp Act or other applicable Indian stamping legislation. The argument is commonly raised in disputes involving foreign investors, who may often have delegated the responsibility to ensure that an agreement is properly stamped to their Indian counterparty and only become aware of a stamp duty compliance issue after a dispute has arisen.

This question has been the subject of conflicting Indian case law, with one line of authority indicating that an arbitration agreement in a document which is found to be not duly stamped cannot be acted upon, such that the document must be "impounded" and the parties directed to pay the requisite stamp duty.

The key contention in *NN Global* was whether the arbitration agreement contained in a Work Order (providing for arbitration seated in India) was enforceable and could be acted upon, even if the Work Order itself was unstamped and unenforceable. The Court considered relevant legislation including the Stamp Act, Arbitration Act and the Contract Act, as well as previous case law, with the assistance of an *Amicus Curiae*. The *Amicus* highlighted the legislative intent behind recent 2015 amendments to the Indian Arbitration Act to "facilitate an unhindered and smooth passage for an application seeking reference to arbitration" and to reduce the involvement of courts at the appointment stage to a *prima facie* examination of the existence of an arbitration agreement. The Court also gave due recognition to Section 16 of the Indian Arbitration Act, which incorporates the principle of

Kompetenz-Kompetenz, namely that the arbitral tribunal may rule on its own jurisdiction, including objections relating to the validity of the arbitration agreement.

Nonetheless, the Supreme Court held (by majority of three to two) that an arbitration agreement which is not stamped will not "exist in law" or be capable of being acted upon. The main practical consequence of this appears to be that in cases where a respondent alleges that a contract governed by Indian law has not been properly stamped, the High Court or the Supreme Court must ascertain that appropriate stamp duty has been paid on the underlying instrument before an arbitral tribunal can be appointed or assume jurisdiction over the proceedings. Given that the requirements for adequate stamping under Indian law can be obscure and the Stamp Act does not provide timelines for the adjudication of the duty payable, delays associated with this process could therefore easily run to weeks or months.

On one hand, by apparently giving primacy to the provisions of the Stamp Act, the decision has resolved the long-standing question under Indian law of whether non-payment or deficient payment of stamp duty on an agreement renders an arbitration clause in that agreement unenforceable. However, by effectively requiring that the Indian courts must – in cases where compliance with stamping requirements is disputed – adjudicate whether the stamping requirements under Indian law have been complied with before a tribunal can be appointed, the decision puts up an additional procedural hurdle to the appointment of tribunals and, in many cases, will likely serve to delay the already time-consuming process of commencing Indian arbitration proceedings.

COMMENTS

Together, these two recent decisions demonstrate that while overall developments in the Indian arbitration landscape demonstrate progress in line with international trends, there remains a tendency for the courts to issue decisions which create the potential for delay, disruption and additional procedural complexities in the arbitral process.

While the Delhi High Court's comments in favour of third-party funding in *Tomorrow Sales* were provided at a high level, the decision will no doubt provide reassurance to funders and funded parties that third-party funding is deemed to be acceptable in the Indian legal market.

It remains to be seen whether India will, in future, seek to regulate the use of third-party funding in arbitration and litigation proceedings (for instance, if it were to follow the Singapore approach, in certain permitted categories of dispute resolution proceedings). In any case, the judgment in *Tomorrow Sales* appears to demonstrate considerable foresight, and India's vast legal market and enormous caseload in domestic litigation and arbitration will doubtless offer huge potential for the commercial third-party funding industry in the future.

By contrast, the Supreme Court's decision in *NN Global* can only be viewed as a backwards step in terms of the pro-arbitration approach which India has developed over the past decade through amendments to the Arbitration Act and a change in judicial approach. Instead of reaching the more practical conclusion (as the dissenting minority did) that preliminary issues concerning whether an instrument is duly stamped should not impede the appointment of an arbitral tribunal, the majority view – effectively making a determination on

stamping a preliminary matter for the courts to determine – only creates the potential for more court intervention in the arbitral process and lengthy procedural delays.

This decision may also impact many ongoing arbitration disputes and pending challenges against awards or enforcement proceedings where there is an argument that the agreement was not duly stamped. It will also benefit parties who wish to delay the arbitration proceedings or resist enforcement of an award, by effectively incentivising them to raise arguments based on alleged failure to comply with stamp duty requirements.

The decision is also likely to pose headaches for Indian arbitral institutions called upon to constitute an arbitral tribunal in cases where it is alleged that a contract has not been properly stamped. This works against India's recent push towards institutional arbitration (instead of *ad hoc* proceedings under the India Arbitration Act) and is ultimately to the detriment of India's ambitions to develop into an international disputes hub. The Supreme Court ruling in *NN Global* also reinforces the general recommendation that foreign investors involved with India-related transactions and/or party to Indian-law governed documents should opt for foreign-seated arbitration proceedings under the rules of a reputable international institution as the preferred dispute resolution mechanism.

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