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ISSN: 2582-6433

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ENFORCEABILITY OF PRE-ARBITRAL DISPUTE RESOLUTION CLAUSES IN INDIA

AUTHORED BY-
SASWATA ROY

ABSTRACT

In this day and age, arbitration is considered an essential dispute resolution method due to it being efficient and fast as compared to court proceedings. That is why, almost all commercial contracts contain an arbitration clause which specifically mentions that any disputes or differences which might arise will be referred to arbitration. However, arbitration can be an expensive process. This led to the use of pre-arbitral dispute resolution clauses in contracts. These clauses contain steps which the parties need to perform before they can refer the dispute to arbitration. Here a question arises as to whether such pre-conditions are considered mandatory or whether the parties can directly refer the dispute to arbitration without following the steps mentioned in the contract.

INTRODUCTION

Pre-Arbitral dispute resolution clauses are clauses where the parties in the contract prescribe a specific process for dispute resolution. The parties decide that if any dispute or differences arise then they will first try to settle the dispute in some way and if such fails then they will go to arbitration. These clauses are also known as multi-tier or escalation clauses.

Such causes are commonly employed in complex construction contracts, service contracts requiring specialised know-how, and turnkey contracts. Generally, these clauses provide for distinct stages, involving separate procedures, for dealing with and seeking to resolve disputes.[1] Thus, such a clause requires parties to negotiate, or mediate, as the first step and only upon failure of efforts taken in the Pre-arbitration Mechanisms will parties be permitted to resort to the final tier, i.e., arbitration.[2]

This is done in an attempt to resolve the dispute by a specified and relatively cheap and cost effective procedure without the necessity of resorting to arbitration, which proves to be, costly and time-consuming in international contracts. The key issues revolving around such multi-tier clauses are the issues of enforcement, i.e., whether the Initial-tiers are enforceable.

VIEW OF THE SUPREME COURT

In the case of *M.K. Shah Engineers and Contractors vs. State of Madhya Pradesh*[3], it was provided that any dispute will first be referred to Superintending Engineer and any party if aggrieved with such decision can refer the case to arbitration. The Supreme Court held that steps preceding the coming into operation of the arbitration clause are essential. However, in this case, the Court held that such steps although essential are capable of being waived and if one party has by its own conduct or the conduct of its officials disabled such

[1] Michael Pryles, *Multi-Tiered Dispute Resolution Clauses*, 18(2) JIA 159, (2001).
[2] Alexander Jolles, *Consequences of Multi-tier Arbitration Clauses: Issues of Enforcement*, 72(4) Arbitration (2006).
[3] (1999) 2 SCC 594.

ISSN: 2582-6433

preceding steps being taken, it will be deemed that the procedural pre-requisites were waived.

In the case of *S.K. Jain v. State of Haryana*[4], the tribunal refused to assume jurisdiction on the basis that the appellant had not complied with certain "mandatory requirements". The petition against the tribunal's decision was dismissed on the basis that the language of the arbitration clause required prior satisfaction of certain conditions.

In *Oriental Insurance Company v. Narbheram Power and Steel*[5], the arbitration clauses were viewed to be construed strictly thus requiring completion of pre-conditions to arbitration. A similar ruling was passed in *United India Insurance Co. v. Hyundai Engineering and Construction Co.*[6] where the agreement was found to be "hedged with conditionality" making non-fulfilment of the pre-conditions render the dispute "non-arbitrable". However, even though the existence of an arbitration agreement was not disputed, the SCI found that the arbitration agreement could be "activated" or "kindled" upon the competition of the pre-conditions, and the same was "sine qua non for triggering the arbitration clause".

There are certain cases where the Supreme Court by undertaking a factual investigation have held that even though pre-arbitral steps are provided in the contract, such steps are only directory. In the case of *Demerara Distilleries Private Limited v. Demerara Distillers Limited*[7], the agreement between the parties provided that differences between the parties are required to be resolved first by mutual discussions, followed by mediation and only on the failure of mediation recourse to arbitration is contemplated. The Supreme Court held that resolving the dispute by mutual discussion and mediation would be an empty formality. The Court justified its decision by placing reliance elaborate correspondences between the parties that has been placed before the court.

In the case of *VISA International Ltd. v. Continental Resources (USA) Ltd.*[8], the arbitration clause provided that disputes which cannot be settled amicably shall be referred to Arbitration. Here also the Supreme Court held that since that parties have taken rigid stands against each other and made allegations against each other, the dispute cannot be settled amicably and the dispute has to be referred to arbitration.

CONTRADICTORY POSITION OF VARIOUS HIGH COURTS

In the case of *Saraswati Construction Co. v. Cooperative Group Housing Society Ltd.*[9] as per the arbitration clause arbitration could only be invoked in a particular manner by calling upon the architect to refer the disputes to arbitration and since notice was not given through the architect, it was argued that the arbitration clause could not be invoked. The learned Single Judge of the Delhi High Court held that the prior requirement as stated for invoking arbitration even if not complied with, the same cannot prevent reference to arbitration, because, the procedure/pre-condition has to be only taken as a directory and not a mandatory requirement. The learned Single Judge in this case relied upon the earlier judgment of a learned Single Judge of the Delhi High Court in the case of *Sikand Construction Co. v. State Bank of India*[10].

[4] (2009) 4 SCC 357.
[5] (2018) 6 SCC 534.
[6] (2018) 17 SCC 607.
[7] (2015) 13 SCC 610.
[8] (2009) 2 SCC 55.
[9] 1995 (57) DLT 343.
[10] ILR (1979) 1 Delhi 364.

ISSN: 2582-6433

The Delhi High Court in *Ravindra Kumar Verma v. BPTP Limited*[11] held that pre-conditions such as conciliation or mutual discussion or similar other procedure would not act as a bar to exercise jurisdiction in light of Section 77 of the Arbitration and Conciliation Act. Section 77 of the Arbitration Act permits a party to initiate arbitration or judicial proceedings, notwithstanding the conciliation proceedings, if such proceedings are necessary for preserving the right of the parties. Accordingly, the court held that existence of conciliation or mutual discussion procedure or similar other procedure is directory in nature.

In *JK Technosoft v. Ramesh Sambamoorthy*[12], the arbitration clause provided that disputes shall be settled amicably by mutual discussion failing which the same shall be settled through arbitration. The Delhi High Court relied upon the ratio of *Ravindra Kumar Verma* and held that the pre-condition was directory and accordingly, ordered the commencement of Arbitration.

The Court in *Union of India v. Baga Brothers*[13], while relying on the judgement of *Ravindra Kumar*, reiterated the directory nature of pre-arbitral steps and held that the appointment of an Arbitrator can be proceeded with even prior to completion of such steps. A similar view has been taken by this Court in further cases like *Siemens Ltd. v. Jindal India Thermal Power Ltd.*[14] and *Sarvesh Security Services Pvt Ltd v. Managing Director, DSIIDC*[15], reaffirming the stance taken in the previously mentioned judgements and restating that pre-arbitral steps are merely optional.

However, the Mumbai High Court has taken a different stance altogether. In *Tulip Hotels Pvt. Ltd. v. Trade Wings Ltd*[16], upheld the enforceability of the multi-tier clause and opined that if the parties prescribe certain preconditions to be adhered to before referring the matter to arbitration, the parties are required to comply with such preconditions and only then refer the matter to arbitration. Accordingly, the petition seeking appointment of Arbitrators was dismissed. Interestingly, in the same year as Tulip Hotels another case before the High Court of Bombay, *Rajiv Vyas v. Johnwin Manavalan*,[17] where the parties had filed for the appointment of Arbitrators pursuant to an Arbitration Clause that contained the pre-conditions of Conciliation before invoking Arbitration. In this case, the court refused to dismiss the application and ordered the dispute to be referred to a conciliator, failing which the matter shall be referred to an arbitral tribunal. Thus, here also the Court followed the pre-arbitral conditions and ordered the dispute to be referred to conciliation before referring it to arbitration.

However, again in the case of *S. Kumar Construction v. Municipal Corporation of Greater Bombay*[18], the Bombay High Court refused to entertain the contention that the pre-arbitral steps are mandatory. But this refusal was due to the language of the contract. In this case, Clause 96 of the General Conditions of the Contract provides that any disputes would first be referred to the Commissioner and if the contractor is not satisfied with the decision of the Commissioner, then the dispute would be referred to arbitration. Clause 97 of the General Conditions of the Contract, on the other hand, provided that all disputes between the parties shall be referred to arbitration. Thus, in Clause 97 there is no reference to Clause 96 which can be said to be a defining feature of the agreement. Hence Clause 97 can be said to be a stand-alone arbitration clause whose invocation is not contingent upon invocation of Clause 96. Clause 97 being widely worded, the disputes which have arisen under Clause 96 and their reference to arbitration can only be one of the facets of Clause 97, but not the only facet.

[11] (2015) 147 DRJ 175.
[12] 2017 SCC OnLine Del 10813.
[13] 2017 SCC OnLine Del 8989.
[14] 2018 SCC OnLine Del 7158.
[15] 2018 SCC OnLine Del 7996.
[16] 2009 SCC OnLine Bom 1222.
[17] 2010 SCC OnLine Bom 1321.
[18] 2017 SCC OnLine Bom 130.

ISSN: 2582-6433

Therefore, invocation of Clause 96 is not a must for invoking Clause 97 and that a claim for the first time can be made before the arbitrator by following the procedure laid down in Clause 97. Due to these reasons, the Court held that pre-arbitral procedures are not mandatory for invoking arbitration.

In *Nirman Sindia v. Indal Electromelts Ltd*.[19], the Kerala High Court held that when the parties to a contract agree to any special mode for resolution of the disputes arising out of the agreement and they are bound to comply with the mode prescribed under the agreement without resorting to the first step provided for the resolution of the dispute in the agreement, they cannot jump to the second step or to the final step to settle the disputes between the parties.

The Rajasthan High Court in *Simpark Infrastructure Pvt. Ltd. v. Jaipur Municipal Corporation*[20], opined that in case an amicable settlement as per the conciliation procedure set forth has been made a condition precedent for invoking the arbitration clause, it is not open to an Applicant to reject the invitation for conciliation. Accordingly, the court held that the arbitration was premature and directed the parties to satisfy the condition precedent for invoking the arbitration clause before seeking an application under Section 11 of the Arbitration and Conciliation Act, 1996.

CONCLUSION

Multi-tier conflict resolution clauses give parties the chance to reach a customised resolution that satisfies the unique requirements of their partnership. Such clauses provide a platform to settle disagreements amicably and protect their future relationship while also assisting in the resolution of minor financial issues without resorting to expensive international arbitration. However Multi-tiered clauses though aimed at providing faster and efficient resolutions than arbitration have proved to be costly in reality. Such multi-tier clauses have led to new disputes of their own resulting in undesirable consequences for the arbitral process on a whole.

Therefore, as can be gathered from the above discussion, the Supreme Court and High Courts have taken several divergent stances over the years when it comes to deciding the nature of pre-arbitral steps as either mandatory or merely directory. It can be concluded that due the reliance placed on factors like the parties' intentions, i.e., the language of the clause in question and the likelihood of success of pre-arbitration procedures, there is no certain answer to that question yet. Here, the subjectivity at play makes it so that some level of judicial discretion can be observed. Although the majority view seems to be in favour of mandatory compliance with pre-arbitral procedures, the Courts on several occasions have recognised the need for a more nuanced position where such procedures may be treated as non-mandatory.

[19] AIR 1999 Ker 440.
[20] 2012 Scc OnLine Raj 3833.