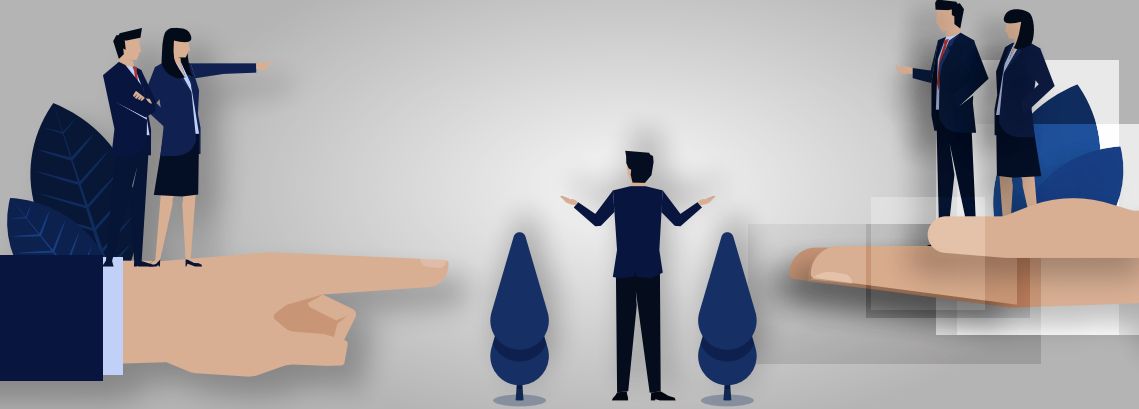


January 2022



High Court of Delhi holds arbitration agreement lacking ‘mutuality’ as invalid¹

Brief Facts

Tata Capital Housing Finance Ltd. (“**Appellant**”) filed an appeal (“**Appeal**”) before the High Court of Delhi (“**Court**”) against an order dated 4 March 2020 (“**Impugned Order**”) passed by a single judge of the Court. By the Impugned Order, the Court had dismissed an application filed by the Appellant under Section 8 of the Arbitration & Conciliation Act, 1996 (“**Act**”). A brief background of the dispute is set out below.

In 2017, Shri Chand Construction and Apartment Pvt. Ltd. (“**Respondent**”) entered into two separate loan agreements with the Appellant for availing loans of INR 23 million and INR 0.8 million respectively. The Respondent deposited original title deeds of an immovable property with the Appellant as security. In 2018, the Respondent cleared the loan amounts due under both the loan agreements and requested the Appellant to return the original title deeds of the property. The Appellant failed to return the original title deeds to the Respondent. The Respondent filed a civil suit before the Court seeking recovery of INR 34 million as damages. However, since the loan agreements contained an arbitration clause, the Appellant filed an application under Section 8 of the Act so that the Respondent could be directed to pursue its claim through arbitration.

Clause 12.18 of the loan agreements, which contained the arbitration clause, provided that “*in the event, the Appellant comes under the purview of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (“**SARFAESI Act**”) or the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (the “**DRT Act**”) by way of a government notification, circular, etc. which enabled the Appellant to proceed and recover dues from the Respondent, the arbitration clause will cease to have any effect at the option of the Appellant*”. The Respondent objected to the application filed by the Appellant under Section 8 of the Act and argued that a valid arbitration clause could not provide for arbitration of the claims of one party and an alternative remedy for the claims of the other party.

Upon analysing the arbitration clause, the single judge by its Impugned Order, held that Section 7 of the Act that defines ‘arbitration agreement’ does not cover clauses that provide for the claims of one party to be adjudicated by arbitration but the claims of the other party to be adjudicated by any other mode. This would be contrary to public policy that prohibits splitting of claims and causes of action. Therefore, the arbitration clause was invalid.

The Appellant challenged the Impugned Order *inter alia* on the following grounds: (i) the SARFAESI Act allows alternative modes of dispute resolution in its legislative framework; and (ii) the arbitration clause will cease to have effect only with respect to the claims that the Respondent has against the Appellant, but not with respect to the claims that the Appellant may have against the Respondent.

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Issue

Whether there existed a valid arbitration agreement between the Appellant and the Respondent?

Judgment

The Court upheld the decision of the single judge and held that the arbitration agreement was invalid as it lacked 'mutuality'. The arbitration clause was worded in such a manner that when the Appellant chooses to enforce the security, the arbitration clause would cease to have any effect, i.e., the Appellant had the option to abandon and nullify arbitration. The arbitration clause did not confer any similar right on the Respondent and therefore, lacked 'mutuality', which is an essential feature of an arbitration agreement. For a valid arbitration agreement, both parties should have the right to seek reference of disputes to arbitration. Since the arbitration clause conferred the right to walk out of arbitration only on the Appellant, with no similar rights provided to the Respondent, it was held to be invalid.

The Court held that an arbitration clause providing for arbitration of the claims of one party and the remedy of approaching the Court or any other fora for the claims of the other party, with respect to the same defined legal relationship, cannot be valid. Hence, the Court dismissed the Appeal and upheld the decision of the single judge dismissing the application under Section 8 of the Act.

Analysis

The Court's decision to hold the arbitration clause, which conferred a unilateral option, i.e., an exclusive right on one of the parties as invalid, is in consonance with the existing jurisprudence on the subject. Mutuality is an essential element of arbitration agreements and the Court rightly upheld the same. Arbitration clauses, which confer unequal and/or unilateral rights on only one of the parties, exacerbate unequal power dynamics between the parties, restricting disadvantaged parties' access to fair justice. Such unilateral option clauses are also hit by Section 28 of the Indian Contract Act, 1872.

Further, splitting of claims that arise from the same defined legal relationship would result in splitting of causes of action and multiplicity of proceedings with the possibility of conflicting judgments. This would also run foul to the settled principles under the Code of Civil Procedure, 1908.

Endnotes

- 1 Authored by Binsy Susan, Partner, Neha Sharma, Senior Associate and Amogh Srivastava, Associate; *Tata Capital Housing Finance Ltd. v. Shri Chand Construction and Apartment Private Limited*, FAO(OS) No. 40/2020 and CM No. 15441/2020, High Court of Delhi, 2021 SCC OnLine Del 5091, judgment dated 24 November 2021.

Coram: Jasmeet Singh and Vipin Sanghi, JJ.

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PRACTICE AREA EXPERTS

Pallavi Shroff

Managing Partner and
National Practice Head Dispute Resolution
+91 98100 99911
E: pallavi.shroff@AMSShardul.com

Rishab Gupta

Partner
+91 98217 80313
E: rishab.gupta@AMSShardul.com

Binsy Susan

Partner
+91 96500 80397
E: binsy.susan@AMSShardul.com

Gauhar Mirza

Partner
+91 70423 98844
E: gauhar.mirza@AMSShardul.com

Tejas Karia

Partner and Head, Arbitration Practice sub-group
+91 98107 98570
E: tejas.karia@AMSShardul.com

Siddhartha Datta

Partner
+91 90070 68488
E: siddhartha.datta@AMSShardul.com

Aashish Gupta

Partner
+91 98189 19857
E: aashish.gupta@AMSShardul.com

Shruti Sabharwal

Partner
+91 98107 46183
E: shruti.sabharwal@AMSShardul.com

Anirudh Das

Partner
+91 98100 98329
E: anirudh.das@AMSShardul.com

Ila Kapoor

Partner
+91 98717 92737
E: ila.kapoor@AMSShardul.com

Smarika Singh

Partner
+91 97170 98075
E: smarika.singh@AMSShardul.com

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