Reportable

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO.6399 OF 2009
(Arising out of SLP(C) No. 21323 of 2007)

The Branch Manager,
M/s. Magma Leasing &Finance Limited & Anr. …Appellants

Versus

Potluri Madhavilata & Anr. …Respondents

JUDGEMENT

R.M. Lodha, J.

Leave granted.

2. The core question that falls to be determined in this appeal by special leave is : does the arbitration agreement survive for the purpose of resolution of disputes arising under or in connection with the contract even if its performance has come to an end on account of termination due to breach ?

3. MAGMA Leasing Limited Public United Company (for short, 'MAGMA') is a financial institution engaged in the

business of providing funds for purchase of plant and machinery and other assets by way of hire purchase. Smt. Potluri Madhavilata-respondent no. 1 (hereinafter referred to as 'hirer) entered into an agreement of hire purchase with MAGMA for purchase of a motor vehicle (Bolero Camper-AP 16 TV 1263) on January 31, 2005. As per the terms of hire purchase agreement, the hirer was required to pay hire purchase price in 46 installments. It appears that the hirer committed default in payment of few installments and as a result thereof, MAGMA seized the said vehicle from the hirer on August 6, 2005. MEGMA also sent a notice to the hirer intimating her that hire purchase agreement has been terminated. Thereafter some correspondence seems to have ensued between the parties.

4. The hirer then filed a suit against MAGMA in the Court of Senior Civil Judge, Vijayawada seeking recovery of possession of the aforesaid vehicle and for restraining MAGMA from transferring the said vehicle.

5. MAGMA, upon receipt of notice of the aforesaid proceedings, made an application (I.A. No. 490 of 2006) before

the trial court under Section 8 of the Arbitration and Conciliation Act, 1996 (for short , 'Act, 1996') read with Section 151 of the Code of Civil Procedure praying therein that the dispute raised in the suit be referred to an arbitrator and the proceedings in the suit be stayed.

6. The hirer contested the aforesaid application on the ground that the hire purchase agreement having been terminated, the arbitration agreement does not survive and the matter need not be referred to the arbitration.

7. The First Additional Senior Civil Judge, Vijayawada vide order dated December 4, 2006 dismissed the application made by MAGMA under Section 8 of the Act, 1996.

8. Not satisfied with the order of the trial court, MAGMA filed a civil revision petition before the High Court of Andhra Pradesh.

9. The Division Bench dismissed the revision petition on April 30, 2007 holding that upon termination of the hire purchase agreement, the arbitration agreement does not survive. The present appeal by special leave arises from this order.

10. Despite service, hirer has not chosen to appear before this court.

11. The hire purchase agreement contains the following clause for arbitration :

> **"22. Arbitration** : All disputes, differences, claims and questions whatsoever arising out of this agreement between magma and/or its representatives and/or its assigns on the one hand and the Hirer/s and the Guarantor/s on the other hand touching and concerning these presents or anything herein contained or in any way relating to or arising from these presents shall be referred to a sole arbitrator to be appointed by Magma Leasing Limited. The Arbitrator so appointed shall formulate his own procedure and shall be entitled to dispense with filing of pleadings or taking of any evidence and shall be entitled to dispose off the proceedings in a summary manner. The Arbitrator shall have summary powers. The award of such arbitrator so appointed shall be final and binding on all the parties to this agreement. Such arbitration proceedings will be at Kolkata. The sole arbitrator shall pronounce the award as expeditiously as possible after entering on the reference or within such time as he may deem expedient. The pronouncement of the award by the arbitrator in a meeting of the parties fixed after the conclusion of the arbitration proceedings shall be deemed to be the publication of the award and shall be construed as the date of receipt of the award by the Hirer/s/Guarantor/s and Magma. The costs and expenses of the arbitration proceedings shall be borne by the Hirer/s/Guarantor/s. The Arbitrator shall hold his sittings at Kolkata."

12. The House of Lords in *Heyman and Another* v. *Darwins Ltd.*[1] had discussed elaborately on the scope of arbitration clause in the context of a dispute arising on the question of repudiation of a contract. That was a case where

[1] (1942) 1 ALL ER 337

the contract was repudiated by one party and accepted as such by another. The contract between the parties contained an arbitration clause providing for that any dispute between the parties in respect of the agreement or any of the provisions contained therein or anything arising thereout should be referred to arbitration. Viscount Simon, L.C., summarised the legal position with regard to scope of an arbitration clause in a contract as follows :

> "An arbitration clause is a written submission, agreed to by the parties to the contract, and, like other written submissions to arbitration, must be construed according to its language and in the light of the circumstances in which it is made. If the dispute is as to whether the contract which contains the clause has ever been entered into at all, that issue cannot go to arbitration under the clause, for the party who denies that he has ever entered into the contract is thereby denying that he has ever joined in the submission. Similarly, if one party to the alleged contract is contending that it is void *ab initio* (because, for example, the making of such a contract is illegal), the arbitration clause cannot operate, for on this view the clause itself is also void.
>
> If, however, the parties are at one in asserting that they entered into a binding contract, but a difference has arisen between them as to whether there has been a breach by one side or the other, or as to whether circumstances have arisen which have discharged one or both parties from further performance, such differences should be regarded as differences which have arisen "in respect of," or "with regard to'" or "under" the contract, and an arbitration clause which uses these, or similar, expressions, should be construed accordingly. By the law of England (though not, as I understand, by the law of Scotland), such an arbitration clause would also confer authority to assess damages for breach, even though it does not confer upon the arbitral body express power to do so.

> I do not agree that an arbitration clause expressed in such terms as above ceases to have any possible application merely because the contract has "come to an end," as, for example, by frustration. In such cases it is the performance on the contract that has come to an end."

Viscount Simon, L.C. concurred with the view expressed by Lord Dunedin in Scott & Sons v. Del Sel, (1923) S.C.(H.L.) 37 and observed:

> "……The reasoning of LORD DUNEDIN applies equally to both cases. It is, in my opinion, fallacious to say that, because the contract has "come to an end" before performance begins, the situation, so far as the arbitration clause is concerned, is the same as though the contract had never been made. In such case a binding contract was entered into, with a valid submission to arbitration contained in its arbitration clause, and, unless the language of the arbitration clause is such as to exclude its application until performance has begun, there seems no reason why the arbitrator's jurisdiction should not cover the one case as much as the other."

13. Lord Macmillan, Lord Wright and Lord Porter though expressed their views separately but all of them agreed with the statement of law summarised by Viscount Simon, L.C..

14. In *Union of India* v. *Kishorilal Gupta and Bros.*[2], Subba Rao, J. (as His Lordship then was) while dealing with the question whether the arbitration clause of the original contract survived after the execution of settlement of the contract referred to the judgment of House of Lords in Heyman exhaustively and held :

[2] (1960) 1 SCR 493

"Uninfluenced by authorities or case-law, the logical outcome of the earlier discussion would be that the arbitration clause perished with the original contract. Whether the said clause was a substantive term or a collateral one, it was nonetheless an integral part of the contract, which had no existence de hors the contract. It was intended to cover all the disputes arising under the conditions of, or in connection with, the contracts. Though the phraseology was of the widest amplitude, it is inconceivable that the parties intended its survival even after the contract was mutually rescinded and substituted by a new agreement. The fact that the new contract not only did not provide for the survival of the arbitration clause but also the circumstance that it contained both substantive and procedural terms indicates that the parties gave up the terms of the old contracts, including the arbitration clause. The case-law referred to by the learned Counsel in this connection does not, in our view, lend support to his broad contention and indeed the principle on which the said decisions are based is a pointer to the contrary.

We shall now notice some of the authoritative statements in the textbooks and a few of the cases bearing on the question raised: In *Chitty on Contract*, 21st Edn., the scope of an arbitration clause is stated thus, at p. 322:

> "So that the law must be now taken to be that when an arbitration clause is unqualified such a clause will apply even if the dispute involve an assertion that circumstances had arisen whether before or after the contract had been partly performed which have the effect of discharging one or both parties from liability e.g. repudiation by one party accepted by the other, or frustration."

In "*Russel on Arbitration"*, 16th Edn., p. 63, the following test is laid down to ascertain whether an arbitration clause survives after the contract is determined:

> "The test in such cases has been said to be whether the contract is determined by something outside itself, in which case the arbitration clause is determined with it, or by something arising out of the contract, in which case the arbitration clause remains effective and can be enforced."

The Judicial Committee in *Hirji Mulji* v. *Cheong Yue Steamship Company {(1926) A.C. 497}* gives another test at p. 502:

> "That a person before whom a complaint is brought cannot invest himself with arbitral jurisdiction to decide it is plain. His authority depends on the existence of some submission to him by the parties of the subject matter of the complaint. For this purpose a contract that has determined is in the same position as one that has never been concluded at all. It founds no jurisdiction."

A very interesting discussion on the scope of an arbitration clause in the context of a dispute arising on the question of repudiation of a contract is found in the decision of the House of Lords in *Heyman* v. *Darwine Ltd.{(1942) All.E.R. 337}.* There a contract was repudiated by one party and accepted as such by the other. The dispute arose in regard to damages under a number of heads covered by the contract. The arbitration clause provided that any dispute between the parties in respect of the agreement or any of the provisions contained therein or anything arising thereout should be referred to arbitration. The House of Lords held that the dispute was one within the arbitration clause. In the speeches of the Law Lords a wider question is discussed and some of the relevant principles have been succinctly stated. Viscount Simon, L.C. observed at p. 343 thus:

> "An arbitration clause is a written submission, agreed to by the parties to the contract, and, like other written submissions to arbitration, must be construed according to its language and in the light of the circumstances in which it is made. If the dispute is as to whether the contract which contains the clause has ever been entered into at all, that issue cannot go to arbitration under the clause, for the party who denies that he has ever entered into the contract is thereby denying that he has ever joined in the submission. Similarly, if one party to the alleged contract is contending that it is void ab initio (because, for example, the making of such a contract is illegal), the arbitration clause cannot operate, for on this view the clause itself is also void.

> If, however, the parties are at one in asserting that they entered into a binding contract, but a difference has arisen between them as to whether there has been a breach by one side or the other, or as to whether circumstances have arisen which have discharged one or both parties from further performance, such differences should be regarded as differences which have arisen "in respect of", or "with regard to", or "under" the contract, and an arbitration clause which uses these, or similar, expressions, should be construed accordingly. By the law of England (though not, as I understand, by the law of Scotland) such an arbitration clause would also confer authority to assess damages for breach even though it does not confer upon the arbitral body express power to do so.
>
> I do not agree that an arbitration clause expressed in such terms as above ceases to have any possible application merely because the contract has "come to an end", as, for example, by frustration. In such cases it is the performance of the contract that has come to an end."

The learned Law Lord commented on the view expressed by Lord Dunedin at p. 344 thus:

> "The reasoning of Lord Dunedin applies equally to both cases. It is, in my opinion, fallacious to say that, because the contract has "come to an end" before performance begins, the situation, so far as the arbitration clause is concerned, is the same as though the contract had never been made. In such case a binding contract was entered into, with a valid submission to arbitration contained in its arbitration clause, and, unless the language of the arbitration clause is such as to exclude its application until performance has begun, there seems no reason why the arbitrator's jurisdiction should not cover the one case as much as the other."

Lord Macmillan made similar observations at p. 345:

> "If it appears that the dispute is as to whether there has ever been a binding contract between the parties, such a dispute cannot be covered by an arbitration clause in the challenged contract. If there has never

> been a contract at all, there has never been as part of it an agreement to arbitrate; the greater includes the less. Further, a claim to set aside a contract on such grounds as fraud, duress or essential error cannot be the subject-matter of a reference under an arbitration clause in the contract sought to be set aside. Again, an admittedly binding contract containing a general arbitration clause may stipulate that in certain events the contract shall come to an end. If a question arises whether the contract has for any such reason come to an end, I can see no reason why the arbitrator should not decide that question. It is clear, too, that the parties to a contract may agree to bring it to an end to all intents and purposes and to treat it as if it had never existed. In such a case, if there be an arbitration clause in the contract, it perishes with the contract. If the parties substitute a new contract for the contract which they have abrogated, the arbitration clause in the abrogated contract cannot be invoked for the determination of questions under the new agreement. All this is more or less elementary."

These observations throw considerable light on the question whether an arbitration clause can be invoked in the case of a dispute under a superseded contract. The principle is obvious; if the contract is superseded by another, the arbitration clause, being a component part of the earlier contract, falls with it. The learned Law Lord pin-points the principle underlying his conclusion at p. 347:

> "I am accordingly of opinion that what is commonly called repudiation or total breach of a contract, whether acquiesced in by the other party or not, does not abrogate a contract, though it may relieve the injured party of the duty of further fulfilling the obligations which he has by a contract undertaken to the repudiating party. The contract is not put out of existence, though all further performance of the obligations undertaken by each party in favour of the other may cease. It survives for the purpose of measuring the claims arising out of the breach, and the arbitration clause survives for determining the mode of their settlement. The purposes of the contract have failed, but the arbitration clause is not one of the purposes of the contract."

Lord Wright, after explaining the scope of the word "repudiation" and the different meanings it bears, proceeded to state at p. 350:

> "In such a case, if the repudiation is wrongful and the rescission is rightful, the contract is ended by the rescission; but only as far as concerns future performance. It remains alive for the awarding of damages, either for previous breaches, or for the breach which constitutes the repudiation. That is only a particular form of contract breaking and would generally, under an ordinary arbitration clause, involve a dispute under the contract like any other breach of contract."

This decision is not directly in point; but the principles laid down therein are of wider application than the actual decision involved. If an arbitration clause is couched in widest terms as in the present case, the dispute, whether there is frustration or repudiation of the contract, will be covered by it. It is not because the arbitration clause survives, but because, though such repudiation ends the liability of the parties to perform the contract, it does not put an end to their liability to pay damages for any breach of the contract. The contract is still in existence for certain purposes. But where the dispute is whether the said contract is void ab initio, the arbitration clause cannot operate on those disputes, for its operative force depends upon the existence of the contract and its validity. So too, if the dispute is whether the contract is wholly superseded or not by a new contract between the parties, such a dispute must fall outside the arbitration clause, for, if it is superseded, the arbitration clause falls with it."

15. In his separate but concurring judgment, A.K. Sarkar, J. (as His Lordship then was) exposited the legal position thus :

> **"**Now I come to the nature of an arbitration clause. It is well settled that such a clause in a contract stands apart from the rest of the contract. Lord Wright said in *Heyman's case* that an arbitration clause "is collateral to the

substantial stipulations of the contract. It is merely procedural and ancillary, it is a mode of settling disputes,.... All this may be said of every agreement to arbitrate, even though not a separate bargain, but one incorporated in the general contract". Lord Macmillan also made some very revealing observations on the nature of an arbitration clause in the same case. He said at pp. 373-4:

> "I venture to think that not enough attention has been directed to the true nature and function of an arbitration clause in a contract. It is quite distinct from the other clauses. The other clauses set out the obligations which the parties undertake towards each other *hinc inde*, but the arbitration clause does not impose on one of the parties an obligation in favour of the other. It embodies the agreement of both the parties that, if any dispute arises with regard to the obligations which the one party has undertaken to the other, such dispute shall be settled by a tribunal of their own constitution. And there is this very material difference, that whereas in an ordinary contract the obligations of the parties to each other cannot in general be specifically enforced and breach of them results only in damages, the arbitration clause can be specifically enforced by the machinery of the Arbitration Act. The appropriate remedy for breach of the agreement to arbitrate is not damages, but its enforcement."

It seems to me that the respective nature of accord and satisfaction and arbitration clause makes it impossible for the former to destroy the latter. An accord and satisfaction only releases the parties from the obligations under a contract but does not affect the arbitration clause in it, for as Lord Macmillan said, the arbitration clause does not impose on one of the parties an obligation in favour of the other but embodies an agreement that if any dispute arises with regard to the obligations which the one party has undertaken to the other, such dispute shall be settled by arbitration. A dispute whether the obligations under a contract have been discharged by an accord and satisfaction is no less a dispute regarding the obligations under the contract. Such a dispute has to be settled by arbitration if it is within the scope of arbitration clause and either party wants that to be done. That cannot be unless the arbitration clause survives the accord and satisfaction. If that dispute is not within the arbitration clause, there can of course be no

arbitration, but the reason for that would not be that the arbitration clause has ceased to exist but that the dispute is outside its scope. I am not saying that it is for the arbitrator to decide whether the arbitration clause is surviving; that may in many cases have to be decided by the Court. That would depend on the form of the arbitration agreement and on that aspect of the matter it is not necessary to say anything now for the question does not arise.

In my view therefore an accord and satisfaction does not destroy the arbitration clause. An examination of what has been called the accord and satisfaction in this case shows this clearly. From what I have earlier said about the terms of the settlement of February 22, 1949, it is manifest that it settled the disputes between the parties concerning the breach of the contract for kettles camp and its consequences. All that it said was that the contract had been broken causing damage and the claim to the damages was to be satisfied "in terms of the settlement". It did not purport to annihilate the contract or the arbitration clause in it. I feel no doubt therefore that the arbitration clause subsisted and the arbitrator was competent to arbitrate. The award was not in my view, a nullity.

The position is no different if the matter is looked at from the point of view of Section 62 of the Contract Act. That section is in these terms:

> "**Section 62**. If the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed."

The settlement cannot be said to have altered the original contract or even to have rescinded it. It only settled the dispute as to the breach of the contract and its consequences. For the same reason it cannot be said to substitute a new contract for the old one. As I have earlier stated it postulates the existence of the contract and only decides the incidence of its breach."

16. In the case of *National Agricultural Coop. Marketing Federation India Ltd.* v. *Gains Trading Ltd.*[3], this Court held thus:

> "6. The respondent contends that the contract was abrogated by mutual agreement; and when the contract came to an end, the arbitration agreement which forms part of the contract, also came to an end. Such a contention has never been accepted in law. An arbitration clause is a collateral term in the contract, which relates to resolution disputes, and not performance. Even if the performance of the contract comes to an end on account of repudiation, frustration or breach of contract, the arbitration agreement would survive for the purpose of resolution of disputes arising under or in connection with the contract. (Vide *Heyman* v. *Darwins Ltd.[(1942)AC356]*, *Union of India* v. *Kishorilal Gupta & Bros (AIR 1959 SC 13)* and *Naihati Jute Mills Ltd.* v. *Khyaliram Jagannath (AIR 1968 SC 522).* This position is now statutorily recognised. Sub-section (1) of Section 16 of the Act makes it clear that while considering any objection with respect to the existence or validity of the arbitration agreement, an arbitration clause which forms part of the contract, has to be treated as an agreement independent of the other terms of the contract; and a decision that the contract is null and void shall not entail *ipso jure* the invalidity of the arbitration clause."

17. Recently, in the case of *P.Manohar Reddy & Bros*. vs. *Maharashtra Krishna Valley Development Corporation And Ors*[4]*.,* while dealing with the argument of the respondent therein that in terms of the contract the claim for extra work or additional work should have been raised during the pendency of the contract itself and not after it came to an end, this Court

[3] (2007) 5 SCC 692
[4] (2009) 2 SCC 494

considered the concept of separability of the arbitration clause from the contract and made the following observations :

> **"27.** An arbitration clause, as is well known, is a part of the contract. It being a collateral term need not, in all situations, perish with coming to an end of the contract. It may survive. This concept of separability of the arbitration clause is now widely accepted. In line with this thinking, the UNCITRAL Model Law on International Commercial Arbitration incorporates the doctrine of separability in Article 16(1). The Indian law — the Arbitration and Conciliation Act, 1996, which is based on the UNCITRAL Model Law, also explicitly adopts this approach in Section 16(1)(*b*), which reads as under:
>
> > "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*."
> >
> > (emphasis supplied)
>
> Modern laws on arbitration confirm the concept.
>
> **28.** The United States Supreme Court in a recent judgment in *Buckeye Check Cashing Inc.* v. *Cardegna [546 US 460 (2005)]* acknowledged that the separability rule permits a court "to enforce an arbitration agreement in a contract that the arbitrator later finds to be void". The Court, referring to its earlier judgments in *Prima Paint Corpn.* v. *Flood & Conklin Mfg. Co.[18 L.Ed. 2d 1270]* and *Southland Corpn.* v. *Keating [465 US 1 (1984)]*, inter alia, held:
>
> > "Prima Paint and Southland answer the question presented here by establishing three propositions. First, as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract."
>
> But this must be distinguished from the situation where the claim itself was to be raised during the

> subsistence of a contract so as to invoke the arbitration agreement would not apply."

18. The statement of law expounded by Viscount Simon, L.C. in the case of *Heyman* as noticed above, in our view, equally applies to situation where the contract is terminated by one party on account of the breach committed by the other particularly in a case where the clause is framed in wide and general terms. Merely because the contract has come to an end by its termination due to breach, the arbitration clause does not get perished nor rendered inoperative; rather it survives for resolution of disputes arising "in respect of" or "with regard to" or "under" the contract. This is in line with the earlier decisions of this Court, particularly as laid down in *Kishori Lal Gupta & Bros.*

19. In the instant case, clause 22 of the hire purchase agreement that provides for arbitration has been couched in widest possible terms as can well be imagined. It embraces all disputes, differences, claims and questions between the parties arising out of the said agreement or in any way relating thereto. The hire purchase agreement having been admittedly

entered into between the parties and the disputes and differences have since arisen between them, we hold, as it must be, that the arbitration clause 22 survives for the purpose of their resolution although the contract has come to an end on account of its termination.

20. The next question, an incidental one, that arises for consideration is whether the trial court must refer the parties to arbitration under Section 8 of the Act, 1996.

21. Section 8 reads thus:

> "**8. Power to refer parties to arbitration where there is an arbitration agreement**.—(1) A judicial authority before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so applies not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration.
>
> (2) The application referred to in sub-section(1) shall not be entertained unless it is accompanied by the original arbitration agreement or a duly certified copy thereof.
>
> (3) Notwithstanding that an application has been made under sub-section (1) and that the issue is pending before the judicial authority, an arbitration may be commenced or continued and an arbitral award made."

22. An analysis of Section 8 would show that for its applicability, the following conditions must be satisfied: (a) that there exists an arbitration agreement; (b) that action has been brought to the court by one party to the arbitration agreement

against the other party; (c) that the subject matter of the suit is same as the subject matter of the arbitration agreement; (d) that the other party before he submits his first statement of the substance of the dispute, moves the court for referring the parties to arbitration; and (e) that along with the application the other party tenders the original arbitration agreement or duly certified copy thereof.

23. Section 8 is in the form of legislative command to the court and once the pre-requisite conditions as aforestated are satisfied, the court must refer the parties to arbitration. As a matter of fact, on fulfillment of conditions of Section 8, no option is left to the court and the court has to refer the parties to arbitration.

24. There is nothing on record that the pre-requisite conditions of Section 8 are not fully satisfied in the present case. The trial court, in the circumstances, ought to have referred the parties to arbitration as per arbitration clause 22.

25. In the result, appeal must succeed and is allowed. The impugned order dated April 30, 2007 passed by the High Court affirming the order dated December 4, 2006 passed by

the First Additional Senior Civil Judge, Vijayawada is set aside. I.A.No.490/2006 in O.S.No.19/2006 is restored to the file of the First Additional Senior Civil Judge, Vijayawada for passing an appropriate order in the light of the observations made hereinabove. Since the respondent has not chosen to appear, no order as to costs.

……J
(Tarun Chatterjee)

……..J
(R. M. Lodha)

New Delhi
September 18, 2009.