THE HIGH COURT OF SIKKIM: GANGTOK

(Civil Appellate Jurisdiction)

DIVISION BENCH: THE HON'BLE MR. JUSTICE BISWANATH SOMADDER, CHIEF JUSTICE
THE HON'BLE MR. JUSTICE BHASKAR RAJ PRADHAN, JUDGE

Arb. A. No. 02 of 2016

1. State of Sikkim,
Through the Principal Secretary,
Finance Revenue & Expenditure Department,
Government of Sikkim.

2. Director,
Sikkim State Lotteries,
Government of Sikkim,
Gangtok. .....Appellants

Versus

M/s Tashi Delek Gaming Solutions (P) Ltd.,
135-Continental Building,
Dr. A.B. Road, Worli,
Mumbai – 18. ..... Respondent

Appeal under Section 37 of the Arbitration & Conciliation Act, 1996

[*against the order dated 29.07.2016 passed by the ld. District Judge, East District at Gangtok, in T.S. (Arbitration) Case No. 02 of 2013 in the matter of M/s Tashi Delek Gaming Solutions (P) Ltd. vs. State of Sikkim & Ors.]*

Appearance:

Mr. Zangpo Sherpa, Additional Advocate General and Mr. Shakil Raj Karki, Government Advocate for the Appellant.

None for the Respondent.

Date of hearing : 25.10.2024
Date of judgment : 12.11.2024

J U D G M E N T

On 25th October, 2024, this Court passed the following order:-

"In this matter, ever since September, 2023, the respondent M/s Tashi Delek Gaming Solutions Pvt.

> Ltd., is not being represented by any learned Advocate. Having given several opportunities to the respondent to be represented before us, we are now left with no option but to conclude the hearing of the matter on the basis of the pleadings on record and the submissions advanced by the learned Additional Advocate General of Sikkim on behalf of the appellants.
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> Hearing stands concluded. Judgment reserved."

We, therefore, now proceed to pronounce our judgment.

2. The learned District Judge has, vide the impugned order dated 29.07.2016, set aside the arbitral award dated 06.06.2011 under section 34(2)(a)(ii) of the Arbitration and Conciliation Act, 1996 (Arbitration Act of 1996) on the ground that the tender process as well as the agreement dated 24.08.2001 had been quashed by this Court, as such, the arbitration clause of the agreement dated 24.08.2001 also became non-existent. The learned District Judge thus held that although the parties had agreed to the arbitration the learned Sole Arbitrator had no jurisdiction to arbitrate the dispute.

THE FACTS

3. An agreement dated 24.08.2001 was entered between the State of Sikkim and the Director, Sikkim State Lotteries (appellants) and M/s Tashi Delek Gaming Solutions (P) Ltd. (respondent). The respondent was

appointed as the sole and exclusive marketing agent for the respondents for initiating the business of Online Computerized Lottery System for a period of seven years with a provision for further extension of five years thereafter. The minimum assured revenue for each of the seven years was agreed upon. After the required infrastructure was set up, the first online computerized lottery game was launched on 05.03.2002. Subsequently, another lottery game was also launched. In the first year, Rs.9,00,00,000/- was paid by the respondent to the appellants by way of bank guarantee which was equivalent to quarter of the minimum assured revenue for the first year. Thereafter, the payment of minimum assured revenue was not according to clause 10 of the agreement dated 24.08.2001. In the meantime, the legality of the tender notice dated 10.07.2001 and the agreement dated 24.08.2001 were challenged before this Court in two writ petitions. This Court quashed the entire process awarding the contract to the respondent and nullified the agreement dated 24.08.2001. Direction was issued to the appellants to issue fresh tender and to complete the entire exercise within three months from 24.06.2003. As a temporary measure, the appellants were granted liberty to: (i) to appoint a competent selectee or

interim marketing agent until the new marketing agent is appointed in pursuance of the fresh tender, or (ii) allow the existing agent to continue for the stipulated period of three months only till such new marketing agent is appointed (whichever is earlier) and that too after clearing off any outstanding dues, government share, if any, or (iii) to make any alternative arrangement for the said period under the wisdom of the State Government. Two days later, on 26.06.2003, the appellants issued a letter requesting the respondent to continue as marketing agent for three more months on the same terms and conditions stipulated in the agreement dated 24.08.2001. Without any letter of acceptance, the respondent continued with the business of marketing online computerized lottery system for the appellants. On 27.06.2003, the respondent requested for reduction of the State's share from 20% to 10%. Numerous correspondences were exchanged between the respondent and the appellants for reduction in the State's share and the minimum assured revenue. On 08.09.2003, the appellants were informed by the respondent that the three months time granted by this Court would be expiring on 24.09.2003. Since the appellants had not been able to float new tender, the respondent expressed their desire to discontinue being

the marketing agent for the Sikkim online lottery. As the appellants were not in favour of reducing the State's share and the minimum assured revenue and further since the dues payable by the respondent had accumulated to a noticeable amount, the respondent by letter dated 11.09.2003 gave notice for arbitration under section 11 of the Arbitration Act of 1996 and by letter dated 04.11.2003 expressed their desire for terminating the agreement dated 24.08.2001. By a letter dated 12.11.2003, the respondent issued notice for termination of the agreement dated 24.08.2001. The letter of termination issued by the respondent was not accepted by the appellants. Thereafter, a supplementary agreement was entered between them on 09.12.2003. By a letter dated 21.12.2003, the appellants reduced the State's share from 20% to 5% and increased the prize pool upto 60%. The minimum assured revenue remained unchanged. Since the dispute between the parties remained unresolved, vide letter dated 05.10.2004, the respondent gave a notice to the appellants for arbitration in terms of the agreement dated 24.08.2001. By a letter dated 20.10.2004, appellants called upon the respondent to pay their dues accumulated since July 2002. On 01.03.2005, a joint meeting was convened between the respondent and the

appellants wherein it was decided to initiate arbitration proceedings and the case was referred to the learned Sole Arbitrator. During the pendency of the arbitration proceedings, the parties entered into another agreement dated 18.11.2005 as an interim agreement on introduction of new games with revised terms. The learned Sole Arbitrator passed the award dated 06.06.2011 holding the respondent liable to pay a total sum of Rs.96,48,38,070.00 to the appellants for the period of 2003-2006 along with interest at the rate 12% per annum. The respondent challenged the award under section 34 of the Arbitration Act of 1996 before the learned District Judge in T.S (Arbitration) Case No.02 of 2013. The learned District Judge set aside the arbitration award.

CONSIDERATION

4. The above facts, as narrated by the learned District Judge in the impugned judgment, makes it clear that the arbitration proceeding was initiated at the instance of the respondent. Therefore, evidently there was a dispute which was unresolved. The narration of facts in the impugned judgment also makes it evident that in terms of the subsequent agreements, the respondent had acted as the appellants' marketing agent and conducted

computerized online lottery. This Court, while quashing the tender process and the agreement dated 24.08.2001, did permit interim measures including allowing the existing agent to continue for the stipulated period of three months only till such new marketing agent was appointed and that too after clearing off any outstanding dues, Government share, if any. It is further clear that although the agreement dated 24.08.2001 had been quashed by this Court, payments were due from the respondent to the appellants. It is therefore certain that there was a dispute between the parties which needed a resolution.

5. The learned District Judge has set aside the arbitral award primarily on the ground that after this Court quashed the tender process and the agreement dated 24.08.2001, the arbitration clause also perished with it relying upon ***Union of India vs. Kishorilal Gupta and Bros.***[1], ***Waverly Jute Mills Co. Ltd. vs. Raymon & Co. (India) Pvt. Ltd.***[2] and ***Jaikishan Dass Mull vs. Luchhiminarain Kanoria and Co.***[3]

6. In ***Kishorilal Gupta*** (supra), it was held that an arbitration clause is a collateral term of a contract as distinguished from its substantive terms; but nonetheless it

[1] AIR 1959 SC 1362
[2] AIR 1963 SC 90
[3] AIR 1974 SC 1579

is an integral part of it; however comprehensive the terms of an arbitration clause may be, the existence of a contract is a necessary condition for its operation, it perishes with the contract.

7. In ***Waverly Jute Mills*** (supra), it was held that an agreement for arbitration is the very foundation on which the jurisdiction of the arbitrators to act rests, and where that is not in existence, at the time when they enter on their duties, the proceeding must be held to be fully without jurisdiction. This defect is not cured by the appearance of the parties in those proceedings, even if that is without protest, because it is well settled that consent cannot confer jurisdiction. But in such a case, there is nothing to prevent the parties from entering into a fresh agreement to refer the dispute to arbitration while it is pending adjudication before the arbitrators, and in that event the proceedings thereafter before them might be upheld as referable to that agreement, and the award will not be open to attack as without jurisdiction.

8. In ***Jaikishan Dass Mull*** (supra), it was held that survival of an arbitration clause was dependent on the legality of the contract and if a contract is illegal and void,

an arbitration clause, which is one of the terms thereof must also perish with it.

9. These judgments were rendered by the Hon'ble Supreme Court interpreting the Arbitration Act, 1940. The Hon'ble Supreme Court in ***Sundaram Finance Ltd. vs. NEPC India Ltd.***[4], had however cautioned:-

> "**9.** The 1996 Act is very different from the Arbitration Act, 1940. The provisions of this Act have, therefore, to be interpreted and construed independently and in fact reference to the 1940 Act may actually lead to misconstruction. In other words, the provisions of the 1996 Act have to be interpreted being uninfluenced by the principles underlying the 1940 Act. In order to get help in construing these provisions, it is more relevant to refer to the UNCITRAL Model Law rather than the 1940 Act."

10. In ***Interplay between Arbitration Agreements under A&C Act, 1996 & Stamp Act, 1899, In Re***[5], the Hon'ble Supreme Court held as under:

> "**115.** The separability presumption has undergone a significant evolution in India. Initially, the Indian courts viewed an arbitration agreement as an integral part of the underlying contract without any existence beyond such contract. For instance, in *Union of India* v. *Kishorilal Gupta & Bros.* [*Union of India* v. *Kishorilal Gupta & Bros.*, 1959 SCC OnLine SC 6], the issue before this Court was whether an arbitration clause in the original contract survived after the enactment of a subsequent contract. K. Subba Rao (as the learned Chief Justice then was) considered *Heyman* [*Heyman* v. *Darwins Ltd.*, 1942 AC 356 (HL)] but distinguished it on the ground that it only dealt with repudiation, where rights and obligations of parties survive the termination of contract. It was held that in situations where the original contract is superseded by a subsequent contract, the arbitration clause in the original contract will also cease to exist. K.

[4] (1999) 2 SCC 479
[5] (2024) 6 SCC 1

Subba Rao, J., speaking for the majority, held that *first*, an arbitration clause is a collateral term of a contract as distinguished from its substantive terms, but nonetheless it is an integral part of it; *second*, the existence of the underlying contract is a necessary condition for the operation of an arbitration clause; *third*, if the underlying contract was non est in the sense that it never came legally into existence or was void ab initio, the arbitration clause also cannot operate; *fourth*, if the parties put an end to a validly executed contract and substitute it with a new contract, the arbitration clause of the original contract also perishes with it; and *fifth*, in situations such as repudiation, frustration, or breach of contract, only the performance of the contract comes to an end, the arbitration clause persists because the contract continues to exist for the purposes of disputes arising under it.

116. In *Damodar Valley Corpn.* v. *K.K. Kar* [*Damodar Valley Corpn.* v. *K.K. Kar*, (1974) 1 SCC 141] , a two-Judge Bench of this Court held that the plea that a contract is void, illegal or fraudulent affects the entire contract along with the arbitration clause. However, the enactment of the Arbitration Act in 1996 enabled the Indian Courts to give effect to the separability presumption with greater impetus. Section 16(1)(*b*), which provides that a decision by the Arbitral Tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause, renders the decisions in *Kishorilal Gupta* [*Union of India* v. *Kishorilal Gupta & Bros.*, 1959 SCC OnLine SC 6] and *Damodar Valley Corpn.* [*Damodar Valley Corpn.* v. *K.K. Kar*, (1974) 1 SCC 141] redundant. Consequently, even if the underlying contract is declared null and void, it will not ipso jure result in the invalidity of the arbitration agreement.

117. In *Firm Ashok Traders* v. *Gurumukh Das Saluja* [*Firm Ashok Traders* v. *Gurumukh Das Saluja*, (2004) 3 SCC 155], the issue before this Court was whether an application under Section 9 of the Arbitration Act moved by a partner of a non-registered firm or by a person not shown as a partner in the Register of Firms was maintainable in view of Section 69(3) of the Partnership Act, 1932. Section 69(3) creates a bar against the institution of a suit to enforce a right arising from a contract unless the firm is registered and the person suing is or has been shown in the Register of Firms as partner. This Court considered the overall scheme of the Arbitration Act to hold that an "arbitration clause is separable from the other clauses of the partnership deed" and "constitutes an agreement by itself".

118. In *National Agricultural Coop. Mktg. Federation India Ltd.* v. *Gains Trading Ltd.* [*National Agricultural Coop. Mktg. Federation India Ltd.* v. *Gains Trading Ltd.*, (2007) 5 SCC 692] , the issue before this Court in an application

under Section 11 was whether an arbitration clause comes to an end if the contract containing such clause is repudiated. While answering this in the negative, this Court observed that even if the underlying contract comes to an end, the arbitration agreement contained in such contract survives for the purpose of the resolution of disputes between the parties. Similarly, in *P. Manohar Reddy & Bros.* v. *Maharashtra Krishna Valley Development Corpn.* [*P. Manohar Reddy & Bros.* v. *Maharashtra Krishna Valley Development Corpn.*, (2009) 2 SCC 494 : (2009) 1 SCC (Civ) 612] , this Court referred to *Buckeye Check Cashing Inc.* [*Buckeye Check Cashing Inc.* v. *Cardegna*, 2006 SCC OnLine US SC 14 : 546 US 440, 444 (2006)] to observe that an arbitration agreement contained in an underlying contract is a collateral term which may survive the termination of the contract.

119. In *Magma Leasing & Finance Ltd.* v. *Potluri Madhavilata* [*Magma Leasing & Finance Ltd.* v. *Potluri Madhavilata*, (2009) 10 SCC 103 : (2009) 4 SCC (Civ) 57] , this Court cited *Heyman* [*Heyman* v. *Darwins Ltd.*, 1942 AC 356 (HL)] with approval to hold that the termination of the underlying contract does not render an arbitration agreement inoperative. It was further observed that the arbitration agreement survives for the purpose of resolution of disputes arising "in respect of", "with regard to", or "under" the underlying contract. The emphasis on the expressions "in respect of", "with regard to" or "under" in *Magma Leasing & Finance* [*Magma Leasing & Finance Ltd.* v. *Potluri Madhavilata*, (2009) 10 SCC 103 : (2009) 4 SCC (Civ) 57] indicates that the purpose of an arbitration agreement is to embody the mutual intention of the parties to settle any disputes that may arise "in respect of" the substantive obligations under the underlying contract. It is, therefore, a logical conclusion that the parties mutually intend to make an arbitration agreement distinct and separate from the underlying contract, so that even if the underlying contract comes to an end, the arbitration agreement survives to resolve any outstanding disputes that may arise out the substantive obligations under the contract.

120. In view of the above discussion, we formulate our conclusions on this aspect. First, the separability presumption contained in Section 16 is applicable not only for the purpose of determining the jurisdiction of the Arbitral Tribunal. It encapsulates the general rule on the substantive independence of an arbitration agreement. Second, parties to an arbitration agreement mutually intend to confer jurisdiction on the Arbitral Tribunal to determine questions as to jurisdiction as well as substantive contractual disputes between them. The separability presumption gives effect to this by ensuring the validity of an arbitration agreement contained in an underlying contract, notwithstanding the invalidity,

> illegality, or termination of such contract. Third, when the parties append their signatures to a contract containing an arbitration agreement, they are regarded in effect as independently appending their signatures to the arbitration agreement. The reason is that the parties intend to treat an arbitration agreement contained in an underlying contract as distinct from the other terms of the contract; and Fourth, the validity of an arbitration agreement, in the face of the invalidity of the underlying contract, allows the Arbitral Tribunal to assume jurisdiction and decide on its own jurisdiction by determining the existence and validity of the arbitration agreement. In the process, the separability presumption gives effect to the doctrine of competence-competence."
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> *[emphasis supplied]*

11. The learned District Judge did not realise that with the enactment of the Arbitration Act of 1996, the view that the arbitration clause was an integral part of the contract and perished with it, had undergone a change. Now, the separability presumption ensures the validity of an arbitration agreement contained in an underlying contract, notwithstanding the invalidity, illegality, or termination of such contract.

12. Consequently, the impugned judgment and order rendered by the learned District Judge cannot be sustained. It is liable to be set aside and is accordingly set aside. The appeal stands allowed.

(Bhaskar Raj Pradhan)
Judge

(Biswanath Somadder)
Chief Justice

Approved for reporting: Yes/~~No~~
Internet : Yes/~~No~~

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