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Delhi High Court holds that an arbitration clause in a contract perishes upon the novation of the contract

The Delhi High Court (“**Delhi HC**”) has in *B.L. Kashyap and Sons Limited v. Mist Avenue Private Limited*¹ *inter alia* held that the arbitration clause in the original contract stands extinguished upon novation thereof.

Brief Facts

In August 2014, B.L. Kashyap and Sons Limited (“**Petitioner**”) entered into a construction contract with Mist Avenue Private Limited (“**Respondent**”) for certain civil and structural works to be undertaken by the Petitioner for a project (“**2014 Contract**”). The 2014 Contract contained an arbitration clause.

Certain disputes arose between the Petitioner and the Respondent. The said disputes were resolved mutually and recorded in a memorandum of understanding (“**MOU**”). The MOU *inter alia* cancelled the 2014 Contract and recorded the terms of settlement arrived at between the Petitioner and the Respondent. However, the MOU did not contain an arbitration clause, and simply stipulated that the Petitioner would be entitled to adopt “*any legal measures*” in case the Respondent failed to make the agreed payment contemplated under the MOU.

On account of the Respondent’s failure to make payment to the Petitioner in terms of the MOU, the Petitioner invoked the arbitration clause contained in the 2014 Contract *inter alia* claiming INR 32,83,865 (Indian Rupees thirty two lakh eighty three thousand eight hundred sixty five) from the Respondent. The Petitioner filed an application under Section 11 of the Arbitration and Conciliation Act, 1996 (“**Arbitration Act**”) for appointment of an arbitrator. The Delhi HC passed an order appointing an arbitrator to settle disputes between the parties.

The main dispute between the Petitioner and the Respondent in the arbitration proceedings pertained to whether the arbitration agreement in the 2014 Contract survived the execution of the MOU. The Ld. Sole Arbitrator passed an award *inter alia* holding that it did not have the jurisdiction to entertain disputes under the arbitration clause contained in the 2014 Contract since the same stood novated upon the execution of the MOU (“**Impugned Award**”).

Being aggrieved by the Impugned Award, the Petitioner filed a petition under Section 34 of the Arbitration Act seeking to set aside the Impugned Award.

The Petitioner *inter alia* contended that the Ld. Sole Arbitrator failed to appreciate that – (a) the Respondent had admittedly failed to make full payment in terms of the MOU and accordingly, the Petitioner was entitled to claim its dues under the 2014 Contract; and (b) the 2014 Contract was not novated by the MOU and resultantly, the arbitration clause survived the execution of the same. The Respondent *inter alia* contended that – (a) the parties had arrived at a settlement in the form of the MOU by which the 2014 Contract stood cancelled; and (b) Given the execution of the

¹ O.M.P. (Comm) 190/2019

MOU, the Petitioner was not entitled to invoke arbitration in terms of the 2014 Contract and seek performance of the same.

Issue

Whether an arbitration clause survives a supervening agreement between the parties?

Findings and Analysis

The Delhi HC dismissed the petition and *inter alia* observed as follows:

1. An arbitration clause contained in an agreement which is *void ab initio* cannot be enforced as the contract itself never legally came into existence.
2. A validly executed contract can be extinguished by a subsequent agreement between the parties;
3. If the original contract remains in existence for the purpose of disputes in connection with issues of repudiation, frustration, breach, etc., the arbitration clause contained therein continues to operate for those purposes.
4. Where the new contract constitutes a wholesale novation of the original contract, the arbitration clause would also stand extinguished by virtue of the new agreement.
5. Interference by the courts with arbitral awards on the ground of patent illegality is permitted only in limited circumstances. The findings of an arbitral tribunal on questions of contractual interpretation are to be respected unless the same are irrational, perverse, or implausible.
6. In the present case, the question of whether the 2014 Contract stands novated by the MOU is a question of contractual interpretation. Under Section 34 of the Arbitration Act, the court is only required to assess whether the provisions of contractual documents are capable of interpretation assigned to them in the Impugned Award.

Considering the above, the Delhi HC held that the Impugned Award does not suffer from patent illegality under Section 34 of the Arbitration Act and consequently, upheld the Impugned Award.

JSA Comment

The findings in this judgment are of importance for parties who choose to enter into subsequent agreements, including settlement agreements, that entirely novate the original contract. Given the finding in this judgment and by way of abundant caution, it would be advisable for parties entering into a subsequent agreement to ensure reinstatement of the arbitration agreement contained in the original contract.

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