



August 2024

'Effect of 'accord and satisfaction' or 'full and final settlement' on arbitration; unsuitability of 'eye of the needle' and 'ex-facie meritless' tests in modern day arbitrations; and role of the referral courts

'Accord and satisfaction' or 'full and final settlement' of claims arising under a contract, do not by themselves, preclude future arbitration in respect of such settled claims, if the party alleges fraud, coercion or undue influence in the execution of the contract. Tests such as 'Eye of the Needle' and 'ex-facie meritless', previously laid down by courts, do not conform with the principles of modern-day arbitration. Referral courts must not conduct an intricate evidentiary enquiry as to whether the claims are time barred and this determination should be reserved for the arbitrator.

In a recent judgment of *SBI General Insurance Ltd. vs. Krish Spinning*¹, the Hon'ble Supreme Court of India ("Supreme Court") has held that parties may refer a dispute to arbitration even after full and final settlement of the contract, if the party said to have executed the contract (*a discharge voucher in the present case*) alleges that the execution was on account of fraud, coercion or undue influence exercised by the other party.

Furthermore, in exercise of its powers under Section 11 of the Arbitration and Conciliation Act, 1996 ("**Arbitration Act**"), the referral court will only look into the existence of the arbitration agreement and will refuse arbitration only where it was manifest that the claims were *ex-facie* time barred, or the claims are *ex-facie* frivolous and non-arbitrable. A referral court may reject arbitration only in exceptional cases where the plea of fraud or coercion appears to be *ex-facie* frivolous and devoid of merit.

The Supreme Court has reiterated and clarified that at the stage of deciding an application under Section 11 of the Arbitration Act, the referral court must not conduct an intricate evidentiary enquiry into the question as to whether the claims are time barred and must leave that determination for the arbitrator.

Brief facts

The brief facts of the case are as follows:

1. Krish Spinning ("**Respondent**") obtained a standard fire and special perils insurance policy from SBI General Insurance Company ("**Appellant**") for a total insured sum of INR 7,20,00,000 (Indian Rupees seven crore twenty lakh), with the period of insurance from March 31, 2008, to March 30, 2019.
2. During the policy period, 2 (two) fire incidents occurred at the Respondent's factory; first incident on May 28, 2018, with the Respondent claiming a loss of INR 1,76,19,967 (Indian Rupees one crore seventy-six lakh nineteen thousand nine hundred and sixty-seven); and the second incident on November 17, 2018, with the Respondent claiming a loss of INR 6,32,25,967 (Indian Rupees six crore thirty-two lakh twenty-five thousand nine hundred

¹ 2024 INSC 532. Judgment dated July 18, 2024.

and sixty-seven). The appeal before the Supreme Court pertained to the disputes arising out of settlement of claims with respect to the first incident. A surveyor was appointed to assess the loss due to the fire incident.

3. Subsequently, the Respondent signed an advance discharge voucher dated January 4, 2019, confirming receipt of INR 84,19,579 (Indian Rupees eighty-four lakh nineteen thousand five hundred and seventy-nine) from the Appellant as the full and final settlement towards its claim. The discharge voucher also stated, *inter alia*, that the Respondent was discharging the Appellant of the liability arising under its claim.
4. Disputes arose between the parties as the Respondent subsequently alleged that it had to sign the final discharge voucher as it was badly in need of money and sought balance claim settlement amounts from the Appellant.
5. As the parties were unable to arrive at any amicable resolution of the dispute and as no arbitrator was nominated by the Appellant in response to the notice invoking arbitration, the Respondent filed a petition for the appointment of arbitrator under Section 11(6) of the Arbitration Act, before the High Court. The High Court allowed the petition and appointed an arbitrator.
6. The Appellant filed a special leave petition before the Supreme Court challenging the Order of the High Court appointing an arbitrator ("**Impugned Order**").

Issues

1. Whether execution of a discharge voucher towards full and final settlement between the parties will operate as a bar to invoke arbitration?
2. What is the scope and standard of judicial scrutiny that an application under Section 11(6) of the Arbitration Act can be subjected to when a plea of '*accord and satisfaction*' is taken by the defendant?
3. What is the effect of the decision of the Supreme Court in *In Re: Interplay between arbitration agreements under the Arbitration Act and the Indian Stamp Act 1899* on the scope of powers of the referral court under Section 11 of the Arbitration Act?

Key findings of the Supreme Court

Re: Whether execution of a discharge voucher towards full and final settlement between the parties will operate as a bar to invoke arbitration.

1. there is no rule of an absolute kind which precludes arbitration in cases where a full and final settlement has been arrived at. In *National Insurance Co. Ltd vs. M/S. Boghara Polyfab Pvt. Ltd*², the discharge voucher was alleged to have been obtained on the ground of coercion and it was observed that a discharge voucher or a no-dues certificate extends only to those vouchers or certificates which are validly and voluntarily executed;
2. mere execution of a full and final settlement receipt or a discharge voucher would not by itself operate as a bar to arbitration when the validity of such a receipt or voucher is challenged by the claimant on the ground of fraud, coercion or undue influence. In other words, where the parties are not *ad idem* over accepting the execution of the no-claim certificate or the discharge voucher, such disputed discharge voucher may itself give rise to an arbitrable dispute; and
3. once the full and final settlement of the original contract itself becomes a matter of dispute and disagreement between the parties, then such a dispute can be categorised as one arising '*in relation to*' or '*in connection with*' or '*upon*' the original contract. And such a dispute can be referred to arbitration under the arbitration clause contained in the original contract, notwithstanding the plea that there was a full and final settlement between the parties.

² (2009) 1 SCC 267

Re: Scope and standard of judicial scrutiny that an application under Section 11(6) of the Arbitration Act can be subjected to when a plea of ‘accord and satisfaction’ is taken by the defendant:

1. relying on *Vidya Drolia and Ors vs. Durga Trading Corporation*³, it was held that in exceptional cases, where it was manifest that the claims were ex- facie time barred and deadwood, the Court could interfere and refuse reference to arbitration. In the context of ‘accord and satisfaction’, this view was recently adopted in *NTPC Ltd. vs. M/s SPML Infra Ltd.*⁴, where the ‘eye of the needle’ test was elaborated, which permits a referral court to reject arbitration in such exceptional cases where the plea of fraud or coercion appears to be ex-facie frivolous and devoid of merit;
2. in the present case however, the Supreme Court held that tests like the ‘eye of the needle’ and ‘ex-facie meritless’, although try to minimize the extent of judicial interference, yet they require the referral court to examine contested facts and appreciate prima facie evidence (however limited the scope of enquiry may be). These tests, as such are not in conformity with the principles of modern arbitration which place arbitral autonomy and judicial non-interference on the highest pedestal; and
3. thus, the position is that ordinarily, in exercise of its powers under Section 11 of the Arbitration Act, the Court will only look into the existence of the arbitration agreement and would refuse arbitration only as a demurrer when the claims are *ex-facie* frivolous and non-arbitrable.

Re: Interplay between arbitration agreements under the Arbitration Act and the Indian Stamp Act 1899 on the scope of powers of the referral court under Section 11 of the Arbitration Act:

1. relying on its seven-Judge Bench decision in *In Re: Interplay Between Arbitration Agreements under the Arbitration and Conciliation Act 1996 and the Indian Stamp Act 1899*⁵, the Supreme Court held that the scope of enquiry at the stage of appointment of arbitrator is limited to the scrutiny of prima facie existence of the arbitration agreement, and nothing else.

The Supreme Court further held that in view of its decision in *In Re: Interplay (supra)*, the observations made in *Vidya Drolia (supra)* that the jurisdiction of the referral court when dealing with the issue of ‘accord and satisfaction’ under Section 11 of the Arbitration Act extends to weeding out *ex-facie* non-arbitrable and frivolous disputes, would no longer continue to apply; and

2. the dispute pertaining to the ‘accord and satisfaction’ of claims is not one which attacks or questions the existence of the arbitration agreement in any way. The arbitration agreement, being separate and independent from the underlying substantive contract in which it is contained, continues to remain in existence even after the original contract stands discharged by ‘accord and satisfaction’; and
3. the question of ‘accord and satisfaction’, being a mixed question of law and fact, comes within the exclusive jurisdiction of the arbitral tribunal, if not otherwise agreed upon between the parties. Thus, the negative effect of competence-competence would require that the matter falling within the exclusive domain of the arbitral tribunal, should not be examined by the referral court, even for a prima facie determination, before the arbitral tribunal first has had the opportunity of looking into it.

Supreme Court’s clarification of the judgment in *M/s Arif Azim Co. Ltd. vs. M/s Aptech Ltd*⁶:

1. the Supreme Court has confirmed the earlier position that while determining the issue of limitation under Section 11 of the Arbitration Act, the referral court must limit its enquiry to examining whether such application is within the limitation period as prescribed under Article 137 of the Limitation Act, 1963, i.e., 3 (three) years from the date when the right to apply accrues in favour of the applicant. The limitation period for filing a petition under Section 11(6) of the Arbitration Act only commences once a valid notice invoking arbitration has been sent by the applicant to the other party, and there has been a failure or refusal on part of that other party in complying with the requirements mentioned in such notice; and

³ (2021) 2 SCC 1

⁴ (2023) SCC Online SC 389

⁵ 2023 INSC 1066

⁶ 2024 INSC 155

2. the Supreme Court has however clarified that at the stage of deciding an application under Section 11 of the Arbitration Act, the referral court must not conduct an intricate evidentiary enquiry into the question as to whether the claims raised by the applicant are time barred and must leave that question for determination by the arbitrator.

Conclusion

This is a significant judgment augmenting the modern arbitration regime in India and examines several important issues which repeatedly arise in present day arbitrations. The Supreme Court has removed yet another obstacle in the way of arbitrations by holding that '*accord and satisfaction*' or '*full and final settlement*' of claims arising under a contract, do not by themselves, preclude future arbitration in respect of such settled claims, if the party (to the contract) alleges fraud, coercion or undue influence in the execution of the contract. Essentially, by doing so, the Supreme Court has underlined the presumption of separability of an arbitration agreement, distinct from the underlying contract. Moreover, the baton to determine the validity of such '*accord and satisfaction*' or '*full and final settlement*', has been passed on from the referral court to the arbitral tribunal.

Additionally, by reading down the test of '*Eye of the Needle*' and '*ex-facie meritless*', the Supreme Court has further restricted judicial interference of the referral court by limiting its powers only to a broad examination of the existence of the arbitration agreement, and refusal to refer disputes to arbitration only in exceptional cases where the claims are manifestly frivolous and non-arbitrable.

Lastly, on the issue of limitation, the Supreme Court by clarifying its earlier judgment in *M/s Arif Azim (supra)*, has further trimmed the powers of the referral court to avoid conducting an intricate evidentiary enquiry of whether the claims are time barred; the determination of which is now reserved for the arbitrator.

Disputes Practice

With domain experts and strong team of dedicated litigators across the country, JSA has perhaps the widest and deepest commercial and regulatory disputes capacity in the field of complex multi-jurisdictional, multi-disciplinary dispute resolution. Availing of the wide network of JSA offices, affiliates and associates in major cities across the country and abroad, the team is uniquely placed to handle work seamlessly both nationally and worldwide.

The Firm has a wide domestic and international client base with a mix of companies, international and national development agencies, governments and individuals, and acts and appears in diverse forums including regulatory authorities, tribunals, the High Courts, and the Supreme Court of India. The Firm has immense experience in international as well as domestic arbitration. The Firm acts in numerous arbitration proceedings in diverse areas of infrastructure development, corporate disputes, and contracts in the area of construction and engineering, information technology, and domestic and cross-border investments.

The Firm has significant experience in national and international institutional arbitrations under numerous rules such as UNCITRAL, ICC, LCIA, SIAC and other specialist institutions. The Firm regularly advises and acts in international law disputes concerning, amongst others, Bilateral Investor Treaty (BIT) issues and proceedings.

The other areas and categories of dispute resolution expertise includes; banking litigation, white collar criminal investigations, constitutional and administrative, construction and engineering, corporate commercial, healthcare, international trade defense, etc.

This Prism is prepared by:



Sidharth Sethi
Partner



Shreya Sircar
Partner



Raghendra Pratap Singh
Senior Associate



Ranked Among Top 5 Law Firms in India for ESG Practice



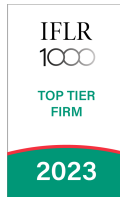
Outstanding
Energy and Infrastructure



Recognised in World's 100 best competition practices of 2024



19 Practices and 19 Ranked Lawyers



12 Practices and 42 Ranked Partners
IFLR1000 APAC Rankings 2023



Among Top 7 Best Overall Law Firms in India and 11 Ranked Practices



18 Practices and 25 Ranked Lawyers

Banking & Finance Team of the Year

Fintech Team of the Year

Restructuring & Insolvency Team of the Year

11 winning Deals in IBLJ Deals of the Year

12 A List Lawyers in IBLJ Top 100 Lawyer List



14 Practices and 38 Ranked Lawyers



Employer of Choice 2024

Energy and Resources Law Firm of the
Year 2024

Litigation Law Firm
of the Year 2024

Innovative Technologies Law Firm of
the Year 2023

Banking & Financial Services
Law Firm of the Year 2022



7 Ranked Practices,
16 Ranked Lawyers

Elite – Band 1 -
Corporate/ M&A Practice

3 Band 1 Practices

4 Band 1 Lawyers, 1 Eminent
Practitioner



Ranked #1

**The Vahura Best Law Firms to Work
Report, 2022**

Top 10 Best Law Firms for Women in
2022



7 Practices and
3 Ranked Lawyers

For more details, please contact km@jsalaw.com

www.jsalaw.com



Ahmedabad | Bengaluru | Chennai | Gurugram | Hyderabad | Mumbai | New Delhi



This prism is not an advertisement or any form of solicitation and should not be construed as such. This prism has been prepared for general information purposes only. Nothing in this prism constitutes professional advice or a legal opinion. You should obtain appropriate professional advice before making any business, legal or other decisions. JSA and the authors of this prism disclaim all and any liability to any person who takes any decision based on this publication.