
(2000) 10 BOM CK 0061
In the Bombay High Court
Case No : Arbitration Petition No. 273 of 1999

Syndicate Bank	Vs	APPELLANT
Kishore Narottamdas Amerchand and Others		RESPONDENT

Date of Decision : 06-10-2000

Acts Referred:

Arbitration Act, 1940 — Section 30
Contract Act, 1872 — Section 15, 56, 65

Citation : (2000) 10 BOM CK 0061

Hon'ble Judges : Vijay Daga, J

Bench : Single Bench

Advocate : H.N. Thakore instructed by T. Jariwala and Associate, for the Appellant; S.J. Purohit, for the Respondent

Final Decision : Dismissed

Judgement

Vijay Daga, J.—The petitioner, Syndicate Bank, is one of the leading nationalised banks of the country having one of its branches at Fort, Mumbai. The respondent No. 1 is a registered broker carrying on business of dealing and/or trading in the shares in the Bombay Stock Exchange, the respondent No. 2 herein (hereinafter referred to as "Stock Exchange" for short).

2. The petitioner has invoked the jurisdiction of this Court u/s 30 of the Arbitration Act, 1940 ("Act" for short) to challenge the award dated 26th March, 1998 passed by the Arbitration Tribunal rejecting the claim filed before it.

FACTUAL MATRIX:

3. In order to appreciate the grievance of the petitioner, few relevant introductory facts need to be noticed at the outset. The petitioner bank, through its "Fund Management Department", is carrying on business of sale and purchase of shares on behalf of its constituents.

4. The respondent No. 1 was registered as one of the brokers with the petitioner bank for the purposes of carrying out dealings in shares, on behalf of the

petitioner bank, at Stock Exchange.

5. The respondent No. 1 on behalf of the petitioner bank, as per its instructions purchased 50,100 shares of M/s Dytron India Ltd. vide Contract Note No. G6/OT/15, dated 5th May, 1992 at the rate of Rs. 20/per share for a total consideration of Rs. 10,02,000/-. The petitioner bank took delivery of the said shares on 5th May, 1992 and forwarded the said shares to the company, viz. M/s Dytron India Ltd. vide its letter dated 12th October, 1992 for transfer of shares in their name but the said letter did not reach the company. It was returned back to the addressee with the postal endorsement, "the office of the company was found closed."

6. The petitioner bank subsequently, came to know that the said company, M/s Dytron India Ltd., was put in liquidation by virtue of an order dated 29th May, 1991, passed by the High Court of Calcutta. In the meanwhile, the petitioner bank learned that on the date when the transaction took place and delivery of shares was given to the petitioner bank i.e. on 5th March, 1992, no trading of the script of M/s Dytron India Ltd. was allowed on the Stock Exchange. Thus, according to the petitioner, the delivery of the said script itself could not have been effected by respondent No. 1 to the petitioner bank as the trading in respect of the said script of M/s Dytron India Ltd. itself was suspended by the Stock Exchange.

7. The petitioner bank, upon learning the aforesaid fact, addressed several letters to respondent No. 1 broker, setting out therein that as per the prevailing rules, regulations and byelaws of the Stock Exchange, respondent No. 1 could not have entered into a transaction on behalf of the petitioner bank as the trading in the scrip of the said company was suspended before the day of transaction in question.

8. The petitioner bank, therefore, in the above backdrop pointed out to respondent No. 1 that the action of respondent No. 1 in making delivery constituted bad delivery as per the rules and regulations and byelaws of the Stock Exchange and the Security Exchange Board of India (SEBI).

9. The petitioner bank, in the above premises, called upon respondent No. 1 to remit the moneys paid by the petitioner bank and to make good the losses suffered by the petitioner. The respondent No. 1 did not reply to the letters of the petitioner and, therefore, the petitioner bank left with no alternative but to file reference before the Stock Exchange i.e. respondent No. 2 for the purposes of seeking adjudication on the petitioner's claim. The said reference was made under the purported arbitration agreement as contained in the contract note pertaining to the transaction in question by virtue of which, according to the petitioner bank, parties were bound to refer the disputes and differences to arbitration of respondent No. 2.

10. The petitioner bank, pursuant to the arbitration agreement incorporated in the contract note, invoked the arbitration clause and sought adjudication of their

dispute. The respondent No. 2 constituted Arbitral Committee consisting of respondent Nos. 3 and 4 herein and referred the differences and disputes between the petitioner bank and respondent No. 1 for resolution to the Arbitral Committee.

11. The petitioner bank filed its statement of claim in the matter before the arbitrators. The respondent No. 1 also filed its reply to the claim statement.

12. The parties to the disputes after completion of their pleadings advanced their oral submissions and also tendered their written notes of arguments in support of their respective oral submissions. The learned arbitrators have thereafter passed their award on 26th March, 1998 and rejected the petitioner's claim holding that the arbitral forum has no jurisdiction to entertain and try the reference in question. Thus, the petitioner's reference was rejected on the ground that the transaction in question was void being forbidden by law, as such, the arbitration agreement forming part of the contract was also void and, consequently, reference was not tenable.

13. Being aggrieved by the impugned award the petitioner bank has preferred this petition to challenge the legality and validity thereof.

RIVAL CONTENTIONS:

14. At the hearing of the petition, it was principally contended on behalf of the petitioner that since the company was being wound up on the date of transaction and delivery of scrip, the transaction in the said shares was not permissible as the trading in the said scrip itself was suspended by Stock Exchange on the day when respondent No. 1 issued contract note. Therefore, respondent No. 1 was guilty of effecting bad delivery, as such, liable to compensate the petitioner. According to the petitioner, the transaction in question being the subject matter of the contract note, the dispute was arbitral by virtue of arbitration clause incorporated therein.

15. The learned counsel for the petitioner bank further submitted that the transaction in question may have been void but the arbitration agreement incorporated in a separate contract note, constituted a separate contract, from the transaction in question. Thus, it was a valid contract. In other words, the submission was made that even if sale of shares was void, the arbitration agreement contained in the contract note cannot be said to be void it being a separate contract. In view of this, the petitioner bank was entitled to invoke arbitration clause so as to get back their monies from respondent No. 1. The learned counsel appearing for the petitioner submitted that the error committed by the arbitrators being apparent on the face of the contract and the Arbitral Forum having failed to exercise the jurisdiction vested in it, the award is liable to be set aside. Lastly, it was submitted that as per sections 56 and 65 of the Contract Act, respondent No. 1 was liable to reimburse the amount or otherwise make good the losses sustained by the petitioner bank.

16. On behalf of respondent No. 1, it was contended by his learned counsel that if the transaction was void as admitted by the petitioner bank, the contract covering the arbitration clause contained therein cannot be said to be a valid agreement. The learned counsel for respondent No. 1 cited few decisions to bolster to his contentions. He sought to place reliance on the Apex Court judgment in the matter of Jaikishan Dass Mull Vs. Luchhiminarain Kanoria and Co., and the judgment of Calcutta High Court in Suwalal Jain Vs. Clive Mills Co. Ltd., .

17. The learned counsel appearing for both the parties referred to the various bye-laws of the Stock Exchange, Bombay in support of their respective submissions.

POINTS FOR DETERMINATION:

18. I have heard the learned counsel for the petitioner bank and respondent Nos. 1 and 2. In the light of the aforesaid rival contentions, the following points arise for my Consideration:

(i) Whether there existed a legal arbitration agreement between the parties so as to justify reference of the dispute to the arbitrators?

(ii) Whether the contract note dated 5th May 1992, giving rise to the dispute between the parties could be branded illegal and void under the byelaws of the Stock Exchange, Bombay?

(iii) If it could be, whether the arbitration clause, which formed integral part of it would be invalid?

(iv) Whether the learned arbitrators failed to exercise jurisdiction vested in them?

CONSIDERATION:

19. Taking the second point first, let us examine whether the transaction in question and, consequently, the contract contained in the contract note in question are legal and valid considering the byelaws of the Stock Exchange, Bombay.

SCHEME OF THE BYELAWS OF STOCK EXCHANGE:

20. The stock transactions at Stock Exchange are governed by Rules, Byelaws and Regulations subject to the provisions of the Securities Contracts (Regulation) Act, 1956 and the Securities Contracts (Regulation) Rules, 1957.

21. The learned counsel for the petitioner bank pressed into service two byelaws, namely, byelaw 140, which deals with the securities of the company in liquidation and byelaw 150, which lays down as to when documents are deemed to be defective. The said byelaws are reproduced hereinbelow:

140. Company in Liquidation. If a Company be wound up at the date of the contract or between the date of the contract and the due date of delivery the

buyer shall nevertheless pay to the seller the purchase money and the seller shall be entitled to recover from the buyer any contribution or call required to be paid even though the liquidator refused to consent to the transfer. If the buyer or his nominee cannot get the securities transferred to his name the seller shall if required to do so by the buyer and the buyer's cost arrange for the assignment of the transferor's title to and the rights in the securities to the buyer or his nominee and for the execution of an irrevocable Power of Attorney in favour of the buyer or his nominee to enable him to recover any return of capital and dividends becoming payable after the date of the contract in respect of the securities bought.

150. Documents When Deemed to Defective. - For purposes of these Bye-laws and Regulations documents shall be deemed defective if there is a defect in their title, ownership, genuineness, regularity or validity or if they are under any lien on account of any debt or liability of the transferor or if they are subject to any attachment or injunction or other legal proceedings or order of Court or other statutory authority for which the seller may be held responsible and the defect shall be deemed to be removed when the title is cleared and/or the ownership, genuineness and validity of the documents established and/or the irregularity rectified and/or the documents released from lien, attachment, injunction or other legal proceedings or order of Court or other statutory authority.

22. It is, thus, contended by the learned counsel for the petitioner bank on the basis of above byelaws that the transaction in securities of the company in liquidation are permitted by the byelaws, of the Stock Exchange and that the documents of title in question being the subject matter of winding up orders and since the same being involved in the legal proceedings are deemed to be defective and the relevant documents of title having been lodged within the prescribed time by the petitioner bank, respondent No. 1 ought to have been held responsible and liable for the defective documents in view of bye-law 150. Thus, in his submission, at any rate the contract cannot be said to be forbidden by law and therefore illegal. The submission therefore is, if the transaction is legal and valid, then, the contract cannot be said to be illegal and void. The arbitration clause being one of the terms thereof it has to be held as legal and valid. The impugned award holding the transaction void and illegal, therefore, suffers from an error apparent on the face of record.

23. In reply, the learned counsel appearing for respondent No. 1 submitted that the byelaws referred to hereinabove by the learned counsel for the petitioner bank are meant for governing the relationship between the buyer and seller and they do not regulate the relationship between the broker and his constituents, as such, the said byelaws are not applicable to the facts of the present case. He placed reliance on byelaw 354 in general and sub-clause (v) thereof in particular and submitted that the said byelaw specifically prohibits the members from entering into the contracts mentioned therein and declares that if any such transaction is entered into in contravention of the said provisions, the same shall

be void. He made a specific reference to clause (v) of the said byelaw 354 and contended that any contract for purchase and sale of securities dealings of which are not permitted on the exchange are void and illegal. The said byelaw 354 reads as under:

354. Void Contracts. -

(a) A member shall not enter into the following contracts and any such contracts if entered into in contravention of the provisions in that behalf contained in these Bye-laws and Regulations shall be void:

(i) contracts for the Clearing in other than Cleared Securities;

(ii) contracts for a period beyond the current and ensuring Clearings in Cleared Securities;

(iii) contracts for hand delivery for a period beyond fourteen days save as provided in these bye-laws and Regulations;

(iv) contracts (other than specific bargains) for purchase and sale of securities dealings in which are not permitted on the Exchange;

(v) contracts for the purchase and sale of prospective dividends;

(vi) carry-over contracts between members and their constituents either as agent to principal or as principal to principal in respect of which contract notes he not rendered to constituents at the special making-up price as provided in these Bye-laws and Regulations.

The learned counsel for respondent No. 1 on the basis of the above bye-law went on the submit that it is an admitted fact on record that much before 5th May, 1992 i.e. on the day when the petitioner was given delivery of the said shares, the Stock Exchange had suspended the trading of the scrip of M/s Dytron India Ltd., as such, the contract in question on the relevant date was void and illegal. In his submission, if a contract was illegal and void, an arbitration clause being one of the terms of the contract also stood perished along with it. In his submission, where the contract does not subsist, the dispute arising therefrom cannot be referred to arbitration as the arbitration clause itself would perish, if the agreement is found to be invalid.

24. Now let us turn to the various authorities cited before me. The Apex Court in case of Waverly Jute Mills Co. Ltd. Vs. Raymon and Co. (India) Private Ltd., , has said :

...This question has been considered by us in Khardah Co. Ltd. vs. Raymon and Co. (India) (P) Ltd., CA Nos. 98 and 99 of 1960 D/ 4-5-1962 (Khardah Company Ltd. Vs. Raymon and Co. (India) Private Ltd.,) with which these appeals were heard and therein we have held that if a contract is illegal and void, an arbitration clause which is one of the terms thereof, must also perish along with it and that a dispute relating to the validity of a contract is in such cases for the

Court and not for the arbitrators to decide. Following that decision we must overrule this contention.

...A dispute as to the validity of a contract could be the subject matter of an agreement of arbitration in the same manner as a dispute relating to a claim made under the contract. But such an agreement would be effective and operative only when it is separate from and independent of the contract which is impugned as illegal. Where, however, it is a term of the very, contract whose validity is in question, it has, as held by us in *Khardah Company Ltd. Vs. Raymon and Co. (India) Private Ltd.*, no existence apart from the impugned contract and must perish with it.

We shall now refer to the decisions cited before us, bearing on this distinction between the two categories of agreements. In *Shiva Jute Baling Limited Vs. Hindley and Company Limited*, the difference between these two classes of agreements was noticed, though in a somewhat different context. A decision directly bearing on this distinction is the one in *East India Trading Co. Vs. Badat and Co.*. There the facts were that there was a general agreement between the parties as to the terms on which they should do business and it was provided therein that all disputes arising out of the contract should be settled by arbitration. Subsequent thereto the parties entered into several contracts and then a dispute arose with reference to one of them. One of the parties denied the contracts and the question was whether an award passed by the arbitrators with reference to that dispute was without jurisdiction. In holding that the arbitrators had jurisdiction to decide the matter by virtue of the agreement antecedent to the disputed one, the Court observed : "Now, the principle of the matter is this that when a party denies the arbitration agreement, the very basis on which the arbitrator can act is challenged and therefore the Court have taken the view that in such a case the arbitrator has no jurisdiction to decide whether he himself has jurisdiction to adjudicate upon the dispute.... If the arbitration agreement is part and parcel of the contract itself, by denying the factum of the contract the party is denying the submission clause and denying the jurisdiction of the arbitrators. But in this case the position is different. We have an independent agreement by which the parties agreed to refer the disputes to arbitration. Pursuant to this agreement, contracts were entered into and when the plaintiffs made a claim against the defendants, the defendants denied their liability, therefore, what was denied was not the jurisdiction of the arbitrators, not the submission clause, but business done pursuant to the submission clause and to which the submission clause applied." That in our judgment is a correct statement of the true legal position.

Now 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 proceedings must be held to be wholly without jurisdiction.

The ratio of the above judgment is clear that if the arbitration agreement is a

part and parcel of the contract itself, by denying the factum of the contract the party is denying the submission clause and thereby denying the jurisdiction of the arbitrators.

25. The Apex Court in another case in Jaikishan Dass Mull vs. Luchhimirain Kanoria and Co. (supra) followed the above-quoted judgment and held that when a contract is invalid, every part of it, including the clause as to arbitration contained therein must also be held invalid. The relevant part of the judgment reads as under :

Now, there can be no doubt that if a contract is illegal and void, an arbitration clause, which is one of the terms thereof must also perish along with it. As pointed out by Viscount Simon, L.C. in *Heyman vs. Darwins Ltd.*, 1942 AC 356. "...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 also is void." The arbitration clause being an integral part of the contract cannot stand, if the contract itself is held to be illegal. Logically speaking, it is difficult to conceive how when a contract is found to be bad, any portion of it can be held to be good. When the whole perishes, its parts must also perish. Ex. nihilo nil fit. On principle, therefore, it must be held that when a contract is invalid, every part of it, including the clause as to arbitration contained therein, must also be invalid. That is also the view taken by this Court in at least two decisions, namely, *Khardah Company Ltd. Vs. Raymon and Co. (India) Private Ltd.*, and *Waverly Jute Mills Co. Ltd. Vs. Raymon and Co. (India) Private Ltd.*, . The question which, therefore, arises for consideration is whether the two earlier contracts dated 13th June, 1969 and the three contracts dated 4th November, 1969 - which are the contracts giving rise to the disputes between the parties - could be branded illegal and void u/s 15, sub-section (3A) of the Forward Contracts Act. If they could be, the arbitration clauses which form an integral part of them would be invalid; otherwise the arbitration clauses would have to be held to be valid.

It is clear from the catena decisions 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 entered into the transaction, the proceedings must be held to be wholly without jurisdiction.

FINDINGS :

26. Now, turning to the facts of the case in hand and having examined the legal scenario it is clear that there is no independent general contract of arbitration providing that all disputes arising out of contract shall be settled by arbitration. There is no separate agreement for reference to arbitration apart from the clause incorporated in the contract note dated 5th May, 1992.

27. In the above backdrop, it is necessary to examine whether the contract in question contained in contract note dated 5th May, 1992 could be branded illegal and void under the byelaws of the Stock Exchange. After having considered the

rival submissions, I am of the view that to attract the arbitration claim, there has to be a valid contract. Byelaw 354(v) clearly debars the sale/purchase of the suspended scrip and mandates that no member shall enter into any such contract and, if entered into in contravention thereof, the transaction shall be void. Therefore, the contract of the petitioner bank with respondent No. 1 was illegal and void vis-a-vis Stock Exchange byelaws and consequently, there could be no arbitration.

28. Having come to the above conclusion, I am of the confirmed view that it was not open for the parties to enter into such transaction on 5th May, 1992 as the contract in question was forbidden by law, as such, illegal. The arbitration clause which formed integral part of the contract could not be given effect to. The taint of illegality attaches to every part of the contract including arbitration clause. It is impossible to say that arbitration clause alone is a legal contract although the rest of the contract is illegal. The arbitration agreement alone cannot survive and, therefore, no fault can be found with the view taken by the learned arbitrators while rejecting and/or dismissing the reference on this count.

29. In view of the above, the petition must fail. The same is therefore dismissed. However, in the facts and circumstances of the case, no order as to costs.