ARBITRATION

CHALLENGING FINALITY OF SETTLEMENTS IN DISPUTE RESOLUTION

KINGS & ALLIANCE LLP
LAW FIRM

info@knallp.com

www.knallp.com

Does Issuance of Discharge Vouchers and No-Claim Certificates Close the Door to Arbitration?

Introduction

A contract is discharged by performance when both parties fulfill their obligations as per the original terms of the agreement. This is referred to as "discharge by performance." Alternatively, a contract may also be discharged through the substitution of new obligations in place of the original ones, followed by the performance of these substituted obligations. This is commonly known as "accord and satisfaction" or "full and final settlement."

The concept of discharge by "accord and satisfaction" is codified in Section 63 of the Indian Contract Act, 1872. This section provides that a promisee may accept substituted obligations in place of the original promise, and upon such acceptance, the original contract is discharged. The intent behind this provision is to provide flexibility to contracting parties to resolve their disputes by agreeing on alternative terms.

The Privy Council in ***Payana Reena Saminathan v. Pana Lana Palaniappa***[1] elaborated on the concept of "accord and satisfaction." It held that when parties mutually agree to settle their disputes through a new arrangement, the prior rights under the original contract are extinguished and replaced by the terms of the new agreement. This process ensures that the obligations under the original contract no longer subsist, and the parties' relationship is governed by the new arrangement.

Separability Of Arbitration Agreement From Underlying Contract

Whether a contract has been discharged is often a mixed question of law and fact. Disputes arising in such contexts are generally arbitrable if the arbitration agreement in the underlying contract survives the discharge of the substantive contract. This principle stems from the doctrine of separability, which ensures that the arbitration clause within a contract remains independent and continues to exist even after the substantive contract is discharged.

The Supreme Court, in ***National Agricultural Coop. Marketing Federation India Ltd. v. Gains Trading Ltd.***[2], emphasized the doctrine of separability by stating that *"even if the underlying contract comes to an end, the arbitration agreement contained in such a contract survives for the purpose of resolution of disputes between the parties."*

[1] (1913-14) 41 IA 142
[2] (2007) 5 SCC 692

Arbitration Agreement Survives Full And Final Settlement Of Obligations Under Underlying Contract

The survival of arbitration agreements post the discharge of substantive contracts has been analysed by the Supreme Court in a myriad of decisions. Courts have consistently taken a position that the mere execution of a "full and final settlement" does not extinguish the arbitration clause unless the parties explicitly agree to terminate it. The intent behind "accord and satisfaction" is to resolve substantive contractual obligations and not to nullify the arbitration clause, unless expressly stated otherwise.

In ***Boghara Polyfab v. National Insurance Co.***[3], the Supreme Court rejected the argument that signing a "full and final discharge voucher" acts as a bar to arbitration. It was held that disputes regarding the validity of such discharge vouchers, especially those involving allegations of fraud, coercion, or undue influence, remain arbitrable.

Furthermore, the Court held that 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 which can be referred to arbitration in accordance with the arbitration clause contained in the original contract, notwithstanding the plea that there was a full and final settlement between the parties.

It is clear from the above discussion that the arbitration clause contained in the contract is not effaced just because a final and full settlement is arrived at between the parties in respect of their obligations in the contract.In the next part of this article, we will analyse grounds which render full and final settlement void. Although, there are several grounds on which a contract be adjudged void which have been enumerated under the Indian Contract Act, in this article we will focus only on economic duress as a ground of rendering the full and settlement void.

Economic Duress As A Ground To Render Full and Final Settlement Void

Before we move further to understand the Indian Position on the economic duress as one of the grounds for declaring a contract void, it would be better to take a look how it has been interpreted and used by foreign courts.

[3] (2009)1 SCC 267

In ***Pao On v. Lau Yiu Long***[4]**,** ***Universe Tankships Inc. v. International Transport Workers Federation***[5]**, and** ***Atlas Express v. Kafco***[6], the UK courts recognized "economic duress" as a valid ground for avoiding a commercial contract. In *Universe Tankships Inc.*, it was held that duress is not the absence of will to submit, but the victim's intentional submission due to the realization that there is no practical choice, which can be evidenced by protest, lack of independent advice, or intention to seek legal redress. The court emphasized that silence does not negate duress if submission was the only viable option. In *Dimskal Shipping Co. v. International Transport Workers' Federation* (1992), the court confirmed that economic pressure could amount to duress if it was a significant cause inducing the party to act.

This principle was applied in India in ***Associated Construction v. Pawanhans Helicopters Pvt. Ltd.***[7]wherein the plea of economic duress was upheld. Furthermore, in ***National Insurance Co. Ltd. v. Boghara Polyfab Pvt. Ltd.***[8], the Supreme Court observed that a contractor, under financial duress and eager to secure the release of admitted amounts, may sign a document, often in a standard or printed format, acknowledging receipt of the amount as full and final settlement. Such a discharge, executed under economic pressure exerted by the employer, cannot be deemed voluntary or as constituting a valid discharge of the contract through accord and satisfaction. Consequently, such a discharge voucher does not preclude the invocation of arbitration to resolve disputes.

Economic duress is now a recognized form of coercion, enabling a contracting party to avoid a contract or its terms. Under Section 16 of the Indian Contract Act, 1872, such coercion may constitute undue influence, where one party, in a position to dominate the will of the other, uses that position to secure an unfair advantage. Section 16(3) further shifts the burden of proof to the dominant party to demonstrate the absence of undue influence in transactions that appear unconscionable on their face or through evidence. Illustrations (c) and (d) to Section 16 specifically address instances of economic duress or undue influence.

Now the next issue that needs consideration is whether the court under section 11 can decide the validity of the full and final settlement. The analysis of this question will be divided into two parts: the position under the 1940 Act and the position under the 1996 Act, both before and after the amendment of 2015.

[4] 1979 (3) All ER 65 (PC)
[5] (1983) 1 AC 366
[6] 1989 (1) All ER 641
[7] AIR 2008 SC 2911
[8] (2009) 1 SCC 267

Whether Referral Court Can Examine Plea Of "Accord and Satisfaction" At Section 11 Stage

Position Under 1940 Act

In one of the earliest decisions delivered by the Supreme Court with respect to deciding the validity of the full and final settlement while determining the application for appointment of arbitrator under Arbitration Act of 1940 was ***Damodar Valley Corporation v. K.K. Kar***[9] wherein it was observed, inter alia, that any dispute arising in relation to the validity of the discharge by "accord and satisfaction" would be covered by the arbitration agreement contained in the original contract, and thus should be referred to the arbitral tribunal for determination.

The court further reinforcing the same position held in ***Bharat Heavy Electricals Ltd. vs. Amar Nath Bhan Prakash***[10] that the question whether there was discharge of the contract by "accord and satisfaction" or not is a dispute liable to be resolved by the arbitral tribunal and the court ought to appoint an arbitrator in such matters when a party approaches it seeking relief for the same.

However, subsequent rulings such as *P.K. Ramaiah and Company v. Chairman and Managing Director, National Thermal Power Corporation*[11] and *Nathani Steels Ltd. v. Associated Constructions*[12] signified a shift in perspective. In *P.K. Ramaiah*, the Court distinguished *Damodar Valley* on factual grounds, holding that once a full and final settlement is reached, no arbitral dispute remains, thus precluding referral to arbitration.

All the above decisions were rendered in context of altogether a different regime in place that is under the Arbitration Act of 1940. However, the position has taken a radical shift after coming into force of the Arbitration Act of 1996 particularly section 11 which empowers the court to appoint arbitrator in case the parties failed to appoint the arbitrator as per their agreed procedure. The question that pricked the court for a long time was whether the court under section 11 can also decide issues which need factual determination or it has to verify the existence of an arbitration agreement before referring parties to arbitration.

Position Under 1996 Act-Before Amendment Act Of 2015

[9] (1974) 1 SCC 141
[10] (1982) 1 SCC 625
[11] 1994 Supp (3) SCC 126
[12] 1995 Supp (3) SCC 324

In ***Konkan Railway Corpn. Ltd. v. Rani Construction (P) Ltd.***[13], the Court observed that the power exercised by the referral court under Section 11 of the Act, 1996 is an administrative power. Thus, the Chief Justice or his designate does not have to decide any preliminary issue at that stage. Accordingly, it held that any issues pertaining to non-arbitrability, validity, and existence of the arbitration agreement are to be decided by the arbitrator.

This view occupied the field until in ***SBP & Co. v. Patel Engg. Ltd.***[14] the court characterized the power conferred upon the Chief Justice or his designate under Section 11 of the Act, 1996 as a judicial power and not merely administrative. It held that the Chief Justice or his designate had the right to decide all preliminary issues at the referral stage under Section 11(6) of the Act, 1996. The Court took this view on the premise that Section 16 of the Act, 1996, which empowers the Arbitral Tribunal to rule on its own jurisdiction, applies only when the parties go before the Tribunal without having taken recourse to Sections 8 or 11 of the Act, 1996 first.

In ***Boghara Polyfab Pvt. Ltd. v. National Insurance Co. Ltd.***[15], the Court, while interpreting Section 11(6) of the Arbitration and Conciliation Act, 1996, delineated three categories of issues for the referral court to consider. The first category includes issues the referral court must decide, such as the existence of an arbitration agreement and whether the party applying under Section 11 is a signatory to such an agreement. ***The second category involves issues the referral court may choose to decide or leave to the arbitral tribunal, such as whether the claim is barred by limitation or if the parties concluded a contract through mutual satisfaction***. The third category, which includes matters like the scope of the arbitration clause or the merits of the claims, is to be exclusively decided by the arbitral tribunal.

The scope of inquiry to be conducted by the court at section 11 stage was significantly enlarged by the second category identified by the court. It empowered the court to go into the validity of the full and final settlement arrived at between the parties and if it was found that the settlement was not validly entered into or was executed under fraud, coercion or undue influence, the matter could not refuse to be sent for arbitration.

The court while further clarifying the position in ***Master Construction Co. v. State of Odisha***[16], held that if the validity of a discharge voucher, no-claim certificate, or settlement agreement is prima facie dubious, there may be no need to refer the dispute to arbitration. ***A mere allegation of financial duress or coercion, unsupported by substantial evidence, would not suffice to establish an arbitrable dispute.***

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[13] (2002) 2 SCC 388
[14] (2005) 8 SCC 618
[15] (2009) 1 SCC 267
[16] (2006) 6 SCC 204

From the above analysis, it is established that the referral courts were conferred with the discretion to conduct mini trials and indulge in the appreciation of evidence on the issues concerned with the subject matter of arbitration. In this backdrop, the Law Commission of India in its 246th report took note of the issue of significant delays being caused to the arbitral process due to enlarged scope of judicial interference at the stage of appointment of arbitrator and suggested.

Position After 2015 Amendment Act

Consequently, the arbitration act was amended and section 11(6A) was introduced which restricted the power of the referral court to verifying the existence of arbitration agreement. It meant that now the validity of the full and settlement executed between the parties could not be gone into by the court.

The Supreme Court while noting this change in ***Duro Felguera, S.A. v. Gangavaram Port Ltd***[17] has held that *"after the amendment, all that the courts need to see is whether an arbitration agreement exists—nothing more, nothing less. The legislative policy and purpose is essentially to minimise the Court's intervention at the stage of appointing the arbitrator and this intention as incorporated in Section 11(6-A) ought to be respected."*

The court in ***United India Insurance Co. Ltd. v. Antique Art Exports Pvt. Ltd.***[18] held that mere bald allegations concerning fraud and coercion being practised while finally settling the disputes cannot justify reference of parties to arbitration. These observations were not in conformity with the statutory changes brought about by the 2015 Amendment Act and therefore were rightly overruled in ***Mayavati Trading Private Limited v. Pradyut Deb Burman***[19] by observing that the position of law existing prior to the 2015 amendment to the Act, 1996 under which referral courts had the power to examine the aspect of "accord and satisfaction" had come to be legislatively overruled by Section 11(6-A) of the Act, 1996.

In ***Vidya Drolia & Ors v. Durga Trading Corporation***[20], the court while reaffirming the principle of minimal judicial interference held that although the arbitral tribunal is the preferred first authority to determine the questions pertaining to non-arbitrability, ***yet the referral court may exercise its limited jurisdiction to refuse reference to arbitration in cases which are ex-facie frivolous and where it is certain that the disputes are non-arbitrable.***

[17] (2017) 9 SCC 729
[18] (2019) 5 SCC 362
[19] (2019) 8 SCC 714
[20] (2021) 2 SCC 1

Now the issue was whether the referral court could go into the plea of accord and satisfaction under section 11 of the Arbitration Act after the 2015 amendment. This issue came up for consideration before the court in in ***Indian Oil Corporation Limited v. NCC Limited***[21] wherein it was held that *"although the referral court under Section 11 of the 1996 Act may look into the aspect of "accord and satisfaction", yet it is advisable that in debatable cases and disputable facts, more particularly in reasonably arguable cases, the determination of whether accord and satisfaction was actually present or not should be left to the arbitral tribunal."*

The court in ***SBI General Insurance Co. Ltd. v. Krish Spinning***[22] disagreed with the view taken by the court in the above judgment and observed that the view taken in Indian Oil (supra) takes a position which was taken by this Court in Boghara Polyfab (supra), wherein it was held that the issue of accord and satisfaction could either be decided by the referring authority or be left for the arbitrator to decide. This pre-2015 position, as was also pointed in Mayavati Trading (supra), was legislatively overruled by the 2015 amendment to the Act, 1996 and the introduction of Section 11(6-A).

Recent Development

The Delhi High Court in a recent decision in ***Union of India through Sr. Divisional Engineer-I Northern Railway Versus B.S Sangwan***[23] after perusing all the decisions of the Supreme Court rendered so far on this point observed that the established legal principle is that the submission of a discharge voucher or no-claim certificate (NCC) by a contractor does not ipso facto preclude the contractor from raising subsequent claims against the employer. ***A contractor may adduce evidence to demonstrate that the execution of such a document was induced by duress, coercion, or economic compulsion.*** However, where it is conclusively established that the discharge voucher or NCC was executed voluntarily, the contractor is estopped from resiling from it or asserting belated claims. Courts or arbitral tribunals are mandated to consider all attendant circumstances, including whether payments were withheld or made contingent upon the issuance of the NCC, to ascertain the voluntariness of its execution.

The court while affirming the award passed by the Arbitrator concluded that *"the decision of the learned Arbitrator that* ***the submission of the NCC was under economic pressure and coercion, and necessitated because of withholding of the processing and payment of the petitioner's bills, cannot be said to suffer from any error of perception*** *much less can it be said to be perverse or shocking to the conscience of the Court. At the very least, it is a plausible*

[21] (2023) 2 SCC 539
[22] 2024 INSC 532
[23] 2024 SCC OnLine Del 6734

view, on the facts which were before the learned Arbitrator. By no stretch of imagination can it be characterised as perverse."

Conclusion

Most of the decisions pertain to whether the dispute should have been referred to arbitration under Section 11 of the Arbitration and Conciliation Act, 1996. Appeals to the Supreme Court in those cases arose from High Court decisions either referring or refusing to refer disputes to arbitration.This distinction is significant because the scope of judicial scrutiny under Sections 11 and 34 is fundamentally different.

Under Section 11, the Court's inquiry at the time of the earlier decisions extended only to determining the existence of an arbitration agreement and an arbitrable dispute. Following the recent ruling in ***SBI General Insurance Co(Supra)***, even the latter aspect is excluded, restricting the Court to verifying the existence of an arbitration agreement. Pre-*SBI General Insurance*, the Court's focus was on whether there was any material suggesting economic duress or coercion in furnishing the NCC or discharge voucher. If such material existed, disputes were referred to arbitration regardless of the merits. Conversely, where the challenge was baseless and lacked supporting material, the Court could decline to refer disputes to arbitration.

The court has brought in a much needed clarity in ***SBI General Insurance Co(Supra)*** by adding that mere appointment of the arbitral tribunal doesn't in any way mean that the referral court is diluting the sanctity of "accord and satisfaction" or is allowing the claimant to walk back on its contractual undertaking. On the contrary, it ensures that the principle of arbitral autonomy is upheld and the legislative intent of minimum judicial interference in arbitral proceedings is given full effect.