Relief Pending

Does Article 14 Belong in Arbitration? The Pre-Deposit Reference in Santosh Associate

The Supreme Court has referred the validity of arbitration pre-deposit clauses to a larger bench. The real question, however, is whether Article 14 of the Constitution belongs at the reference stage of an arbitration that Section 18 of the Arbitration Act or even contract law could settle.

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a claimant as a precondition to arbitration is legally valid. The reference was necessitated by the fact that the Division Bench expressed disagreement with a decision of a full bench (3 judges) of the Supreme Court *in* *S.K. Jain v. State of Haryana* (2009), where a similar clause was upheld as valid. The reference is a welcome development inasmuch as it will clear the ambiguity around such pre deposit clauses. However, the earlier line of cases which test the validity of such pre-deposit clauses against constitutional standards in what should be a purely an Arbitration Act and/or private law issue, raises important questions that a larger bench would do well to address.

Facts

The Appellant held a works contract with HSIIDC awarded through a tender. Clause 25-A(vii) of the contract made the reference to arbitration non-maintainable unless the contractor first furnished a security deposit on a slab basis: 2% for claims below ₹10,000, 5% up to ₹1 lakh, and 10% for claims of ₹1 lakh and above. At the end of the arbitration the deposit was adjusted against any costs awarded against the contractor, and the balance, or the whole sum if no costs were awarded, was refunded within one month of the award. At the threshold, HSIIDC made an application under Section 16 of the Arbitration and Conciliation Act, 1996 ('Arbitration Act') to the appointed arbitrator challenging his jurisdiction because the pre-deposit had not been made by the Appellant. The Arbitrator ruled in favour of HSIIDC and directed the Appellant to make the deposit, and dismissed the claim when it refused. The Commercial Court, Gurugram dismissed the Appellant's Section 37 appeal, relying on *S.K. Jain v. State of Haryana* (2009). The Appellant then appealed to the Supreme court.

Discussion of Law

The Supreme Court in *Santosh Associate* draws from a line of earlier Supreme Court cases to arrive at its holding and reference to a larger bench.

S.K. Jain v. State of Haryana (2009): In this case, a full bench (3 judges) of the Supreme Court had the opportunity to examine a pre-deposit clause similar to one in question in *SK Associate*. The claimant contractor in a public works contract had to pay a refundable security deposit to the Haryana Government to invoke arbitration under the arbitration clause of the said contract. The Court upheld this

Notably, while arriving at the judgment, the Court rejected the arguments of unequal bargaining power in commercial contracts citing *Central Inland Water Transport Corp. Ltd. v. Brojo Nath Ganguly* (1986). It stated that there was no compulsion on anyone to enter into these contracts and that it was voluntary on both sides rejecting allegations of state power. It also rejected arguments on doctrine of fairness (to be undertaken by the State) given it is an administrative law concept and refused to invoke any additional public law standards for the State's dealings in the performance of contracts.

Icomm Tele Ltd. v. Punjab State Water Supply and Sewerage Board and Anr. (2019): Here, a Division Bench (2 judges) of the Supreme Court through Justice Rohinton Nariman examined the validity of a '*deposit-at-all*' condition in the arbitration clause for a public works contract tendered by the Punjab State Water Supply and Sewerage Board. The clause stipulated a 10% deposit to invoke arbitration by the claimant contractor which would be refunded only in proportion to the percentage success of the claim amount.

The Court here struck down this deposit-at-call clause. It differentiated the facts from *SK Jain*. The clause in question in *SK Jain* stipulated a refundable deposit as opposed to an essentially non-refundable clause in *Icomm*. Further, there was no plea taken in *SK Jain* that the arbitration clause was violative of Article 14 of the Constitution.

It is interesting that *SK Jain* rejected the invocation of public law standards for the State in the contractual sphere, but the Court in *Icomm* seems to have imported Article 14 and public law commitments of the State into the contractual sphere as well. The Court cited *ABL International Ltd. v. ECGIL* (2004) to hold that the State has the responsibility to act fairly and reasonably in terms of Article 14 even in the contractual sphere. The Court emphasised that arbitration is an important alternate dispute resolution process and must be encouraged given the high pendency of cases in the courts and cost of litigation. It held that the clause as such defeats the very purpose of alternate dispute resolution given that it would discourage claims and render arbitration expensive and ineffective.

Lombardi Engineering Ltd. v. Uttarakhand Jal Vidyut Nigam Ltd. (2024): In this case, a full bench of the Supreme Court speaking though Justice JB Pardiwala had the

fixed deposit for security. However, no criteria for eligibility or conditions for refund of the security deposit was mentioned in the clause. Given the ambiguity and vagueness of the clause, the Court struck it down. In doing so, also held the clause as violative of Article 14 of the Constitution.

Notably, upon an examination of previous Supreme Court and High Court judgement, the Court also held that there was no conflict between *Icomm* and *SK Jain*. The clauses in question in those cases were on a different footing. More interestingly, what the Court picked up on was the observation in *Icomm* that no plea of Article 14 reasonableness was taken in *SK Jain*.

The Court dedicated a whole section to whether the validity of a pre-deposit condition can be decided on the anvil of Article 14 and be decided in a petition to appoint an arbitrator under Section 11 of the Act. The Court held that a referral court under Section 11(6) can test an arbitration clause against Article 14 since the arbitration agreement sits below the Constitution and the 1996 Act in the grundnorm hierarchy. Party autonomy therefore cannot extend to terms that violate fundamental rights, and a contractor's consent to a pre-deposit clause at the time of contracting does not estop it from challenging that clause. Relying on *Olga Tellis v. Bombay Municipal Corpn.* (1985) and *Basheshar Nath v. CIT* (1958), the Court held that the Article 14 right cannot be waived.

Discussion in *Santosh Associate*

The starting point of the reasoning of the Court in *Santosh Associate* was approvingly citing from Justice Hrishikesh Roy's opinion in *Central Organisation for Railway Electrification (CORE) v. ECI SPIC SMO MCML (JV)* (2025) concerning Section 18 of the Arbitration Act which mandates equal treatment of parties across all stages of arbitral proceedings as being mandatory and non-derogable.

However, it also cited from the portion of the majority judgment in *CORE* which cited *Lombardi* to the extent of holding that party autonomy cannot be stretched to an extent where it violates fundamental rights of parties under the constitution.

It found that unlike *Lombardi* which found no conflict between *SK Jain* and *Icomm*, *Icomm* indeed is in conflict with *SK Jain*. The Court said *Icomm* could not have overridden the ratio of *SK Jain* even though the Court was in *prima facie* agreement

reiterated that the right to sue inheres in every individual and it is no defence to contend that there is no such right. Unlike an appeal, the maintainability of a suit requires no statutory sanction. It also said that such pre-deposit clauses fall foul of Section 28 of the Indian Contract Act, 1972 which voids any contractual stipulation that restrains parties from enforcing contractual rights by the 'usual proceedings in ordinary tribunals'.

Having said this, the Court said that it was of the view that an arbitration clause cannot impose pre-deposit conditions so onerous as to render the right to sue illusory or nugatory. A stipulation mandating the deposit of a substantial percentage of claim amount as a precondition to invoking arbitration would inevitably, suppress claims, deter recourse to ADR, and defeat its very object.

Consequently, the court framed the following questions for reference to a larger bench:

1. *Whether a stipulation requiring the contractor alone to make a pre-deposit of security/fees prior to reference of disputes to arbitration is contrary to Section 18 of the Act, which mandates equal treatment of parties at all stages of arbitration*
2. *Whether pre-deposit conditions in contracts having an arbitration clause discourage Alternative Dispute Resolution and undermine its objective of declogging the court system?*
3. *Whether a condition of pre-deposit of security/fees prior to reference to arbitration is arbitrary and violative of the right to sue, as well as Article 14 of the Constitution and Section 28 of the Indian Contract Act, 1872?*
4. *Whether a requirement of pre-deposit of security/fees has any rational relation to the object of curbing frivolous claims? At that stage it cannot be said that the claims are frivolous, and such claims may in any case be addressed through costs under Section 31(8) of the Act at the conclusion of the arbitral proceedings.*
5. *Whether a pre-deposit condition is valid in an arbitration case where the deposit is refundable upon the conclusion of the arbitration proceedings?*
6. *Whether S.K. Jain v. State of Haryana (2009) is a valid and binding precedent?*

intervened far more in arbitration-related proceedings. After BALCO, courts have been far more hands-off in dealing with arbitration, and far more attentive to party autonomy and the equality of parties under the Arbitration Act. I postulate that *SK Jain* would never have upheld such a unilateral pre-deposit clause had BALCO come to pass before it. Even so, what *SK Jain* did well, even if its conclusion may have been wrong, was to refuse to invoke administrative and public law principles at the stage of arbitration reference. In doing so, it stated that the State is not liable to fulfil its duties in the contractual sphere in the same way it does when carrying out its sovereign and public functions.

There is no doubt that the grant of tenders by public authorities can be scrutinised by courts, as it is essentially a public and sovereign function of the State. However, it would be better if the State were treated as any other private party once a public works contract is entered into, and its performance and the disputes arising from it come to be adjudicated, much like *SK Jain* held.

The problem has been that the Supreme Court has since been reading Article 14 reasonableness and administrative law principles into the functioning of essentially private contracts when it ought not to. This is apparent not just from *Icomm* and *Lombardi*. In *CORE* too, where the Supreme Court held unilateral appointments of arbitrators by one disputing party impermissible, the majority opinion said that Article 14 could be read into public-private contracts.

Lombardi, *Icomm*, and *CORE* invoked Article 14 in the context of arbitration, but the Supreme Court has also been allowing Article 14 to be read into the State's contractual dealings more generally as well (See for example, *Madras Aluminium Co. Ltd. v. T.N. SEB* (2023)).

Reading Constitutional Standards into the State's Contracts Is Unfair to Everyone

The problems with this approach are apparent on the face of it. It is fair neither to the State nor to private parties in general for Article 14 to be read into the State's functions in the contractual realm.

The State does exercise its commercial weight in all its contracts. It is a monopsony and can extract very favourable terms from contractors, terms which a contractor

Article 14 then becomes a blunt weapon to attack anything perceived as less than palatable in the State's commercial contracts. Commercial contracts should not be interfered with in this manner. The bargain struck by the parties should be upheld.

Most of the pre-deposit cases deal with one State party and one private party. What if such a pre-deposit clause were introduced in an arbitration clause between two private parties — say, a private contractor and a private owner? Would the court uphold such a clause? Article 14 cannot be invoked against a private party. By giving an Article 14 justification rather than a statutory one, the courts end up creating situations where clauses may be valid not on the basis of what their content is but who the parties are.

This persistent widening of constitutional principles to test and challenge anything is akin to using a bazooka to kill a mosquito, when a humble spray would have sufficed.

The Solution

This view is further elaborated in Justice Hrishikesh Roy's dissent in *CORE*. Agreeing with Justice Narasimha that public law principles evolved in constitutional and administrative law should not generally be imported into arbitration law, he held that equality between the arbitrating parties must be anchored in the framework of the Arbitration Act itself, with the obligations of fair treatment grounded in Sections 12 to 15 and Section 18 of the Act. Importing constitutional principles at the Section 11 stage, in his view, would defeat the very objective of the Arbitration Act and depart from the norm of minimal judicial intervention.

The solution here was simple. The humble spray referred to above would have been Section 18 of the Arbitration Act, which mandates equal treatment of parties. Had Section 18 alone been used, such pre-deposit clauses would have been outlawed simpliciter on the basis of the statute, as opposed to the Constitution, which cannot be enforced against private parties and opens a Pandora's box for the State.

And even in the contractual sphere, if the fear is that the State will not perform its duties in good faith, instead of reading Article 14 reasonableness, courts can infer duties of good faith in commercial contracts. Although good faith dealing in

constitutional challenges.

The *Santosh Associate* judgment also refers to Section 28 of the Indian Contract Act (which declares agreements in restraint of legal proceedings void) and the common law right to sue. These are other instruments, short of the Constitution, available to courts to restrict pre-deposit clauses. The resort to Article 14 is, therefore, perplexing.

Conclusion

The problem with the line of cases relation to arbitration pre-deposits is apparent. To the credit of the bench in *Santosh Associate*, the precise questions for reference also delineate whether the validity of such pre-deposit clauses should be tested against Article 14.

Given the problems delineated above in importing constitutional provisions into the arbitration and private law realm, it is hoped that the larger bench looking into this issue will be open to considering the very doctrinal basis upon which these will be tested to be valid or invalid. Justice Roy's and Narasimha's opinions in *CORE* will be a good starting point for the larger bench, when constituted.

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