SUPREME COURT'S ARBITRABILITY BONANZA: WITH A PINCH OF SALT?

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Abstract

*The three-judge bench decision of the Supreme Court of India in Vidya Drolia and Ors v. Durga Trading Corporation, ["**Vidya Drolia**"] returned findings on arbitrability of tenancy disputes, subject-matter arbitrability, and who shall decide arbitrability. This paper examines Vidya Drolia judgment and highlights its contributions as well as limitation in the Indian arbitration landscape.*

I. INTRODUCTION

The evolution of arbitration law from an "*alternative*" method of dispute resolution to a preferred and thriving mechanism of time-bound resolution has been truly remarkable. With the Indian backyard growing into an economic powerhouse, a need has been felt for efficient, autonomous, and effective arbitration of disputes, especially prominent in commercial spheres, and foreign jurisdictions like the US, Singapore, the EU, and Australia. Unfortunately, the Indian judicial system has been extra cautious in opening up to this global trend and fully embracing the most sacrosanct principles of arbitration being - party autonomy and *kompetenz-kompetenz*.

On questions of '*subject-matter arbitrability*', over the years, various concurrent High Courts and even the Hon'ble Supreme Court of India ["**SCI**"] has been at loggerheads. The ever-looming issue of "subject-matter arbitrability" was addressed first by the SCI in its landmark judgement in *Booz Allen and Hamilton v. SBI Home Finance Limited and Others*[1] ["***Booz Allen***"]. The "Test of Arbitrability" propounded by the SCI classified: (a) *rights in rem* as exclusively amenable to the jurisdiction of courts, while (b) rights *in personam* could be adjudicated through arbitration in terms of the agreement between parties. However, while the Test broadly classified arbitrability of disputes, it failed to address on the determination of a public grievance *vis-à-vis* a private grievance. In years to come, this would allow parties to colour personal disputes as public offences and seek reliefs before a Court of law, outside of an arbitrator's jurisdiction. The SCI also would go on to unequivocally hold questions of fraud and public consequences as non-arbitrable[2].

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[1] Booz Allen & Hamilton v. SBI Home Finance Ltd. & Ors., (2011) 5 SCC 532.

[2] N. Radhakrishnan v. Maestro Engineers & Ors., (2010) 1 SCC 72.

Yet, significant leaps have been taken towards a pro-arbitral regime, since. Notably, the SCI in *Booz Allen* itself clarified that the ' in *rem* – in *personam'* rule was flexible. It was held that disputes concerning subordinate rights in personam were arbitrable, despite having arisen from a right in rem.

However, on substantive issues of arbitrability of frauds, tenancy disputes, and intellectual property disputes to the 'special court' exclusion, Indian courts have, time and again, failed to tame the dragon. In *A. Ayyasamy v. A. Paramasivam & Ors.*[3] ["**Ayyaswamy**"] the SCI paved the way for arbitrability of simple issues of fraud. However, no definitive principles compartmentalizing simple allegations of fraud, from serious frauds were laid down. Thus, determination of nature and particular issues of fraud was left open to interpretation by arbitral tribunals and Courts on a case-to-case basis. As regards the jurisdiction of 'exclusive courts', disputes arising under special statutes, (even concerning rights *in personam*) have been held as in-arbitrable[4]. However, the Delhi High Court in *HDFC Bank Limited v. Satpal Singh Bakshi*[5] ["**Satpal Singh**"], held that disputes under the debt recovery tribunal's jurisdiction may also be submitted for arbitration. But, the three-judge bench of the SCI over-ruled *Satpal Singh* in *Vidya Drolia & Ors v. Durga Trading Corporation*[6] ["**Vidya Drolia**"]. Thus, doubt has been created over the arbitrability of disputes covered under special statutes.

The SCI in *Emaar MGF Land Limited v. Aftab Singh*[7] held consumer disputes as non-arbitrable. However, applying the tests laid down in *Vidya Drolia*, consumer disputes invoking *in personam* rights of a party may fall within the jurisdiction of an arbitral tribunal (in the absence of express or implied restriction under Consumer Protection Act, 1986). The SCI judgement in *Himangi Enterprises v. Kamaljeet Singh Ahluwalia*[8] ["**Himangi Enterprises**"] rendered an archaic anti-arbitral approach, holding civil courts to have exclusive jurisdiction both under Transfer of Property Act, 1882 as well as special rent legislations. However, *Himangi Enterprises* was met w equal criticism, and a coordinate bench of the SCI disagreeing with the judgement referred the question of non-arbitrability of tenancy disputes to a larger bench[9].

Therefore, to address such pertinent issues on 'subject-matter arbitrability', the SCI judgment in *Vidya Drolia* sheds much-needed clarity on the issue. However, the reasoning of the SCI on some

[3]A. Ayyasamy v. A. Paramasivam & Ors, (2016) 10 SCC 386.

[4]Kingfisher Airlines Limited v. Prithvi Malhotra Instructor, 2012 SCC OnLine Bom 1704.

[5]HDFC Bank Limited v. Satpal Singh Bakshi, 2012 SCC OnLine Del 4815

[6]Vidya Drolia & Ors v. Durga Trading Corporation, 2019 SCC OnLine SC 358.

[7]Emaar MGF Land Limited v. Aftab Singh, (2019) 12 SCC 751.

[8]Himangi Enterprises v. Kamaljeet Singh Ahluwalia, (2017) 10 SCC 706. Judgment is now over-ruled by Vidya Drolia and Ors v. Durga Trading Corporation, 2019 SCC OnLine SC 358.

[9]Vidya Drolia and Ors v. Durga Trading Corporation, 2019 SCC OnLine SC 358.

crucial issues of arbitrability still requires clarity. This paper attempts to critically evaluate the *Vidya Drolia* judgment.

II. VIDYA DROLIA & OTHERS V. DURGA TRADING CORPORATION

The three-judge bench of the SCI comprising Justice N.V. Ramana, Justice Sanjiv Khanna, and Justice Krishna Murari has, in *Vidya Drolia,* returned significant findings on a number of crucial aspects of arbitrability. The decision has been rendered primarily in response to reference to consider arbitrability of tenancy disputes, wherein the SCI has now declared tenancy disputes as arbitrable, except where the tenancy dispute is governed by specific rent control legislations granting exclusive jurisdiction to special forums for adjudication of the dispute. Further, the SCI in a detailed judgment has also, upheld arbitrability of *simplicitor* frauds and significantly compartmentalized the scope of court intervention in pre-arbitral processes.

A. Four-Fold Arbitrability Test

With a view to streamline the test of '*arbitrability of a dispute',* the SCI has finally laid down its analysis on crucial aspects of subject-matter arbitrability. The SCI reasoned that arbitration as a dispute resolution mechanism is conceptual as well as consensual in nature and hence in disputes affecting third party rights and liabilities (who are not bound by the arbitration agreement), reference to arbitration proceedings would not be appropriate. Thus, disputes which do not deal with rights *in rem,* but only involve subordinate rights *in personam* (despite arising from a right *in rem*) would be arbitrable. The fourfold litmus test has accordingly been laid down as the determining factor whether a dispute mentioned in the arbitration agreement is arbitrable or not ("Four-Fold Test"):

1) Whether the subject matter and cause of action relates to a right in *rem*, and does not concern subordinate rights in *personam* arising from any rights in *rem*;
2) Whether the subject matter and cause of action has an *erga omnes* effect i.e. affecting third-party rights for which centralized adjudication, and not arbitration is suitable and/or enforceable;
3) Whether the subject matter and cause of action concerns (i) public interest; (ii) sovereign rights and (iii) State functions for which arbitration would not be suitable and/or enforceable; mutual adjudication would be unenforceable; and
4) Whether the cause of action and subject-matter is in-arbitrable, implicitly in terms of the governing statute.

The SCI has held that only if the answer to any of the aforesaid questions is in affirmative, would the dispute be held as non-arbitrable. Notably, the SCI cautioned against mechanical application of the four-fold test and opined that the test when applied holistically and judiciously would assist courts in ascertaining arbitrability of disputes with a greater certainty.

Applying the aforesaid tests, the pertinent questions of arbitrability lucidly settled by the SCI include the following categories of disputes:

i. Tenancy Disputes

While overruling the ratio laid down in *Himangni Enterprises v. Kamaljeet Singh Ahluwalia*[10], the SCI has held landlord-tenant disputes as arbitrable. Besides the Four-Fold Test on rights *in personam*, the SCI also relied on the reasoning supplied in *Booz Allen* where it was held that *"Disputes relating to subordinate rights in personam, arising from rights in rem have always been considered to be arbitrable."* The SCI held that tenancy disputes did not concern (ii) sovereign rights and (iii) State functions inalienable and sovereign functions of the State. However, since tenancy disputes were subject-matter of rent control legislation, the same would not be arbitrable in light of a specific forum/ court having exclusive jurisdiction over such matters. Such rights and obligations can only be adjudicated and enforced by the specified forum/ court, and not through arbitration.

ii. Fraud

The SCI has held that the allegations of fraud can be made a subject matter of arbitration when they relate to a civil dispute. The SCI however has clarified that fraud, which would vitiate and invalidate the arbitration clause, would cause a dispute to be in-arbitrable. The SCI observed that on allegations of fraud, parties would oppose arbitration, contending that the arbitral tribunal and process would not be equipped to investigate and consider such serious issues of fraud. However, the SCI added that arbitrators, just like the courts, are equally well equipped to handle disputes in accordance with the general public policy of the law. Further, chances of failure of non-abidance of public policy consideration under legislation, which otherwise doesn't expressly or by necessary implication exclude arbitration, cannot form the basis of nullifying the arbitration agreement. Therefore, the SCI *prima facie* disagreed with the mistrust placed on arbitral tribunals as an "*inferior adjudication procedure*" by any standard. Thus, the SCI upheld its previous decision in *Avitel Post*[11] and overruled the ratio in in *N. Radhakrishnan*[12], holding that fraud can be a ground to refuse reference to arbitration

[10]Himangi Enterprises v. Kamaljeet Singh Ahluwalia, (2017) 10 SCC 706.
[11]Avitel Post Studioz Limited v. HSBC PI Holdings (Mauritius) Limited, 2020 SCC OnLine SC 656.
[12]N. Radhakrishnan v. Maestro Engineers and Ors, (2010) 1 SCC 72.

only if: (i) a prima facie case of absence of arbitration agreement or clause was made out; or (ii) allegations of fraud, mala fide or arbitrary conduct were made out against the State or State bodies, requiring public enquiry.

iii. Debt Recover Tribunal

The SCI has held disputes which are to be adjudicated by the Debt Recovery Tribunal as non-arbitrable. The SCI held that if claims of financial institutions and banks falling within the purview of the Debt Recovery Laws were granted permission to be submitted to arbitrations, then the same would amount to infringement of statutory rights conferred upon these institutions through the Debt Recovery Laws. It would even violate the rights to various modes of recovery as granted by the Debt Recovery Laws to these banks and financial institutions.

Applying the Four-Fold Test, the SCI observed that where the statute expressly forbids dispute resolution through arbitration, thereby prescribing adjudication in a specific manner and bestowing unique rights that cannot be upheld or utilized through arbitration, then such cases are barred from arbitration. Since exclusive jurisdiction of the Debt Recovery Tribunal is recognized by necessary implication, banks and financial institutions are implicitly barred from submitting disputes to arbitration.

iv. Other Issues

Further, applying the Four-Fold Test, the SCI has held that insolvency or intra-company disputes have to be submitted before public courts of law or specialized forums (if created). The Court recognized that such actions concerned rights *in rem* and public forums would prove to be more efficacious in dealing and disposing of such matters expeditiously. Similarly, registration of trademarks, grant and issue of patents, etc. are matters of public importance falling within the sovereign's functions and having an *erga omnes* effect. Thus, such rights or disputes concerning the same were held to be non-arbitrable. In the same breath, criminal matters have also been classified as non-arbitrable owing to State's duty to address such matters of public cause and consequence.

B. Forum deciding Non-Arbitrability?

The SCI has also expounded on raising of the issue of non-arbitrability at the following stages:

(a) At the time of Section 11 proceedings or Section 8 of the Arbitration Act, 1996 ["**A&C Act**"] before Court for appointment of the arbitrator or stay of court proceedings respectively; or

(b) During the course of arbitration proceedings before an arbitral tribunal; or

(c) During the course of proceedings before the court challenging award enforcement of the same.

However, the SCI held that an arbitral tribunal shall be the Court of the first instance for adjudication on the issue of arbitrability. Courts while adjudicating a matter under Section 11 of Section 8 of the Arbitration Act, would only look into issues of arbitrability if the arbitration agreement *prima facie* did not exist or the dispute between the parties was demonstrably in-arbitrable. At the same time, Courts under Section 34 could exercise limited powers of deciding on arbitrability of the matter, while determining a challenge to the award. In doing so, the SCI has held that the ratio laid down in the earlier decision of SCI in *SBP v. Patel Engineering Ltd*[13] was held as bad law, inasmuch as it permitted only a limited administrative satisfaction on presence of agreement to arbitrate between the parties, and not a judicious decision on its validity.

III. LIMITATIONS AND CONCLUDING REMARKS

The SCI's pro-arbitration stance in this case has brought about tremendous clarity on the reference of disputes to arbitration basis application of the Four-Fold Test. The judgment is certainly a positive step towards a pro-arbitral regime and recognition of 'party autonomy' in the country.. Further, the judgement has already created some legitimate concerns. Application of the Four-Fold Test cannot be applied unanimously to hold all tenancy disputes amenable to 'arbitration'. Tenancy disputes concerning rights '*in rem*' or '*erga omnes* effect' would fall outside the purview of arbitration and Courts/ tribunals would be required to adjudicate on arbitrability of such disputes on a case-to-case basis. Time would tell how arguments of '*in rem–in personam'* rights practically pan out before Courts.

In furtherance of the Four-Fold Test, the SCI has held that since the Recovery of Debts and Bankruptcy Act, 1993 ["**RBD Act**"] lays down a specific manner and mechanism of recovery, banks and NBFCs falling under the purview of the Act would not be allowed to arbitrate their claims. However, a closer look at the RDB Act reveals no restriction on the adjudication of claims outside of the Court/ before a tribunal, basis mutual agreement between customers and banks. The limited option of only recovery through Debt Recovery Tribunal only takes away the opportunity of speedy redressal of disputes before an arbitral tribunal.

The judgement also makes broad observations questioning the arbitrability of shareholder and consumer disputes without dealing with them conclusively. The judgement further tends to expand the limited scope of review available under Section 11, in case the Court finds the dispute to be expressly 'non-arbitrable' (despite the 2015 amendment restricting the scope of the Court's power to identify the presence of an arbitration agreement). Expanding the scope of such powers under Section

[13]SBP v. Patel Engineering Ltd, (2005) 8 SCC 618.

11, threatens to re-open the pandora's box of Courts over-reaching the limited consideration required under Section 11.

Importantly, the judgment only deals with Part I of the Arbitration Act and the "Four-Fold Test" is applicable only to domestic arbitrations. It remains to be seen what version of a narrower "Four-Fold Test" would be adopted by Courts for arbitrability of disputes for foreign awards in India under Part II of the Arbitration Act.

Notwithstanding the said reservations, the case will hopefully demonstrate an arbitration-friendly jurisprudence of the SCI and its intent to recognize and promote the arbitral process as an alternative dispute resolution mechanism in the coming times.