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 decides arbitrability. This paper examines Vidya Drolia judgment and highlights its contributions as well as limitation in the Indian arbitration landscape.*

I. INTRODUCTION

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, 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 hanging sword of "subject-matter arbitrability" was first addressed by the SCI in its landmark decision of *Booz Allen and Hamilton v. SBI Home Finance Limited and Others*[1] ["***Booz Allen***"], where the Court laid down the "Test of Arbitrability" and held disputes concerning: (i) rights *in personam* to be amenable to arbitration; and (ii) *rights in rem* to be adjudicated by courts and public tribunals. While this test clearly compartmentalized arbitrability, it suffered from major lacunae. It was observed that a disgruntled party, attempting to circumvent arbitration in cases concerning personal rights, would intentionally try and bring its case within the purview of a right *in rem* and seek relief outside the purview of the arbitrator's jurisdiction.[2]

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

[2]Radhika Dubey & Aman Singhania, *Arbitrable or Not – India at Crossroads?,* INDIA CORPORATE LAW- A CYRIL AMARCHAND MANGALDAS BLOG (Oct. 5, 2020), https://corporate.cyrilamarchandblogs.com/2020/10/arbitrable-or-not-india-at-crossroads/.

From the era of *Booz Allen* and *N. Radhakrishnan v. Maestro Engineers & Ors.*[3], where issues of public consequences and fraud were held non-arbitrable, there has been definitive progress towards a pro-arbitration regime. In fact, the SCI in *Booz Allen* cautioned against a strict application of the '*rem – personam'* distinction by notably clarifying "*This is not however a rigid or inflexible rule. Disputes relating to subordinate rights in personam, arising from rights in rem have always been considered to be arbitrable*."

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, missed taming the dragon. In *A. Ayyasamy v. A. Paramasivam & Ors.*[4] ["**Ayyaswamy**"] the SCI cleared the impasse over arbitrability of frauds. However, no affirmative principles on what would constitute simple or serious allegations of fraud were laid down. Questions of arbitrability of particular issues of fraud remain largely open to interpretation and determination by Courts. Further, it has been long considered that in case of special statutes vesting exclusive jurisdiction upon a particular court, disputes (even concerning rights *in personam*) may not be open to arbitration[5]. However, the Delhi High Court in *HDFC Bank Limited v. Satpal Singh Bakshi*[6] ["**Satpal Singh**"], held that disputes forming the subject-matter of jurisdiction of the debt recovery tribunals may be subject to arbitration. But, three judge bench of the SCI over-ruled *Satpal Singh* in *Vidya Drolia & Ors v. Durga Trading Corporation*[7] ["**Vidya Drolia**"]. Thus, again doubt is created about arbitrability of disputes covered by the special statutes. The SCI in *Emaar MGF Land Limited v. Aftab Singh*[8] held consumer disputes as non-arbitrable. However, applying the tests laid down in *Vidya Drolia*, some consumer disputes involving *in personam* rights may fall within purview of arbitration (in the absence of express or implied restriction under Consider Protection Act, 1986). The SCI judgement in *Himangi Enterprises v. Kamaljeet Singh Ahluwalia*[9] ["**Himangi Enterprises**"] rendered an archaic anti-arbitral approach, holding civil courts to have exclusive jurisdiction in cases of both special rent legislation and the Transfer of Property Act, 1882. However, *Himangi Enterprises* was met with an equal criticism, and a coordinate bench of the SCI referred the issue of arbitrability of landlord tenancy dispute to a three-judge bench of the Court[10].

[3]N. Radhakrishnan v. Maestro Engineers & Ors., (2010) 1 SCC 72.
[4]A. Ayyasamy v. A. Paramasivam & Ors, (2016) 10 SCC 386.
[5]Kingfisher Airlines Limited v. Prithvi Malhotra Instructor, 2012 SCC OnLine Bom 1704.
[6]HDFC Bank Limited v. Satpal Singh Bakshi, 2012 SCC OnLine Del 4815
[7]Vidya Drolia & Ors v. Durga Trading Corporation, 2019 SCC OnLine SC 358.
[8]Emaar MGF Land Limited v. Aftab Singh, (2019) 12 SCC 751.
[9]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.
[10]Vidya Drolia and Ors v. Durga Trading Corporation, 2019 SCC OnLine SC 358.

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 crucial issues is still not satisfactory. 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 dispute. Further, the SCI in a detailed judgement 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 exposition on the crucial aspect 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), resorting to arbitration proceedings would not be suitable. Thus, disputes which do not involve rights *in rem* but deal with subordinate rights *in personam* (even if arising from rights *in rem*) are 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 cause of action and subject matter of the dispute relates to actions in *rem*, that do not pertain to subordinate rights in *personam* that arise from rights in *rem*;
2) Whether cause of action and subject matter of the dispute affects third party rights; have *erga omnes* effect; require centralized adjudication, and mutual adjudication would not be appropriate and enforceable;
3) Whether cause of action and subject matter of the dispute relates to inalienable sovereign and public interest functions of the State and hence mutual adjudication would be unenforceable; and

4) Whether the subject-matter of the dispute is expressly or by necessary implication non-arbitrable as per mandatory statute(s).

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*[11], 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 landlord-tenant disputes do not relate to inalienable and sovereign functions of the State. However, as an exception landlord-tenant disputes covered and governed by rent control legislation have been held as non-arbitrable when a specific court or forum has been given exclusive jurisdiction to apply and decide special rights and obligations. Such rights and obligations can only be adjudicated and enforced by the specified court/forum, 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, is an aspect relating to non-arbitrability. The SCI noted that historically parties opposed arbitration of disputes where allegations of fraud were made primarily on ground that arbitrators and the arbitral process were ill-equipped to consider such matters. 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 a legislation, which otherwise doesn't expressly or by necessary implication exclude arbitration, cannot form the basis of nullifying the arbitration agreement. Therefore, it was held that "*it would be grossly irrational and completely wrong to mistrust and treat arbitration as flawed and inferior adjudication procedure.*" The SCI accordingly has upheld the ratio laid down in

[11]Himangi Enterprises v. Kamaljeet Singh Ahluwalia, (2017) 10 SCC 706.

Avitel Post[12] and overruled its previous decision in *N. Radhakrishnan*[13], holding that fraud can be a ground to refuse reference to arbitration only if: (i) a clear case was made out where the arbitration clause or agreement itself cannot be said to exist; or (ii) allegations are made against the State or its instrumentalities of arbitrary, fraudulent, or mala fide conduct which requires a public enquiry.

iii. Debt Recover Tribunal

The SCI has observed that the disputes which are to be adjudicated by the Debt Recovery Tribunal are 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 hold arbitrations proceedings, 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 the relinquishment of the jurisdiction of the Debt Recovery Tribunal is forbidden by necessary implication, consequently the claims of financial institutions and banks are barred from being resolved through arbitration as per the statute itself.

iv. Other Issues

Further, while applying the Four-Fold Test, the SCI has held that insolvency or intra-company disputes have to be addressed by a centralized forum, be it the court or a special forum, which would be more efficient and have complete jurisdiction to efficaciously and fully dispose of the entire matter. They are also actions *in rem*. Similarly, grant and issue of patents and registration of trademarks are exclusive matters falling within the sovereign or government functions and have *erga omnes* effect. Such grants confer monopoly rights and are accordingly held as non-arbitrable. In the same, breath criminal cases have also been held as non-arbitrable as they relate to sovereign functions of the State.

B. Forum deciding Non-Arbitrability?

The SCI has also expounded on raising of issue of non-arbitrability at the following three (3) stages which are:

[12]Avitel Post Studioz Limited v. HSBC PI Holdings (Mauritius) Limited, 2020 SCC OnLine SC 656.
[13]N. Radhakrishnan v. Maestro Engineers and Ors, (2010) 1 SCC 72.

(a) Before the court on an application for reference under Section 11 of the Arbitration Act, 1996 ["**A&C Act**"] or for stay of pending judicial proceedings and reference under Section 8 of the Arbitration Act; or

(b) Before the arbitral tribunal during the course of the arbitration proceedings; or

(c) Before the court at the stage of the challenge to the award or its enforcement.

However, the SCI grants preference to the arbitral tribunal as the preferred first authority to determine and decide all questions of non-arbitrability. The courts have been conferred with the power to have a 'second look' on aspects of non-arbitrability post the award as per Section 34 of the Arbitration Act. The SCI further states that court may interfere at the Section 8 or Section 11 stage when it is manifestly and *ex-facie* certain that the arbitration agreement is non-existent, invalid or the disputes are non-arbitrable. However, the nature and facet of non-arbitrability would, to some extent, determine the level and nature of judicial scrutiny. This restricted and limited review is only to check and protect parties from being forced to arbitrate when the matter is demonstrably 'non-arbitrable'. In doing so, the SCI has held that the ratio laid down in *SBP v. Patel Engineering Ltd*[14] is not good law, inasmuch as it permitted only a limited administrative satisfaction on existence of an arbitration agreement, and not a judicious one.

III. LIMITATIONS AND CONCLUDING REMARKS

The SCI's pro-arbitration stance in this case has brought about tremendous clarity on reference of disputes to arbitration basis the Four-Fold Test laid down. The judgment is certainly a positive step towards the spirit of recognizing the principle of 'party autonomy' in India. However, the judgment cannot be broadly understood to mean that all disputes in relation to tenancy are arbitrable. Tenancy disputes having any element of '*in rem* action' or '*erga omnes* effect' will continue to be non-arbitrable and will have to be assessed on a case-by-case basis. It remains to be seen how arguments of '*in rem–in personam'* practically pan out before Courts.

Further, the judgement has already created some legitimate concerns. In furtherance of the Four-Fold Test, the SCI has held that since the Recovery of Debts and Bankruptcy Act, 1993 ["**RBD Act**"] provides for specific modes of recovery, the claims of banks and NBFCs which are covered under the scope of the said Act, will not be arbitrable. This is despite the fact that the RDB Act contains no prohibition on adjudication and reliefs by a tribunal basis mutual agreement between banks and customers. The limited option of only Debt Recovery Tribunal being made available to banks and

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

NBFCs threatens to affect timely resolution of disputes through arbitrations filed by banks and NBFCs.

The judgement also makes broad observations questioning the arbitrability of shareholder and consumer disputes without dealing with them conclusively. Further, the SCI's expansion of scope of review under Section 11 of the A&C Act in the circumstances when the matter is demonstrably 'non-arbitrable' (which, since the 2015 amendment to the Arbitration Act, was limited to checking the existence of an arbitration agreement only) is seen as widely disruptive and conservative. It remains to be seen how Section 11 matters will play out in courts.

Importantly, the SCI has delivered the judgement only in the context of Part I of the A&C Act and the "Four-Fold Test" is inapplicable to foreign awards under Part II. 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 Section 48(2)(a) of the Arbitration Act.

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