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Supreme Court lays down law on arbitrability



Landlord-Tenant disputes are arbitrable, rules Supreme Court; whilst simultaneously laying down law on subject matter arbitration and who decides on arbitrability.

The ever evolving regime of arbitration law in India brought about by diverse judgments and frequent amendments has left both litigants and courts perplexed in its wake. However, a three judge bench of the Supreme Court (“SC”) in its recent verdict in *Vidya Drolia & Ors. v. Durga Trading Corporation*^[1] (“*Vidya Drolia*”) has attempted to definitively lay down the law regarding two important propositions, viz. (i) meaning of subject matter arbitrability, and (ii) the conundrum – who decides the question of non-arbitrability.

Vidya Drolia promises to have widespread ramifications, similar to the SC’s oft-cited judgments of *Booz Allen & Hamilton*^[2] and *Garware Wall Ropes*^[3].

Background

Vidya Drolia arises out of a reference made by the Division Bench casting doubt on the earlier judgment passed by a coordinate bench in *Himangni*

Enterprises^[4], wherein the suit was for recovery of arrears of rent and permanent injunction, and the tenancy in question was not protected by the rent control legislation. The SC, in *Himangni Enterprises*, held that landlord-tenant disputes governed by the Transfer of Property Act, 1882 were not arbitrable as this would be contrary to public policy.

Question of Non Arbitrability of the Dispute

The question of which subject matters are arbitrable has long been mulled over by various courts in India. An attempt has been to expand the scope of arbitration to promote India as an arbitration friendly jurisdiction and to minimize involvements of courts in the realm of alternate dispute resolution mechanisms. The SC has therefore propounded a four-fold test for determining when the subject matter of a dispute in an arbitration agreement is not arbitrable, when the cause of action / subject matter of the dispute:

1. relates to actions *in rem*, and do not pertain to subordinate rights *in personam* that arise from rights *in rem* – a judgment *in rem* settles the rights themselves and binds all parties claiming an interest in the dispute even though the judgment is pronounced in their absence. On the contrary, a judgment *in personam*, merely determines the rights of the litigants *inter se*.
2. affects third party rights – the contractual and consensual nature of arbitration underpins its ambit and scope. Therefore, the authority and power being derived from an agreement cannot bind and is non-effective against non-signatories.
3. relates to sovereign and public interest functions of the State – such functions being inalienable and non-delegable, the State alone has the exclusive right and duty to perform such functions.
4. is expressly or by necessary implication non-arbitrable as per mandatory statute(s) – it is necessary to examine if a statute creates a special right or liability, and provides for determination of each right or liability by a specified court or public forum so constituted, and whether remedies beyond the ordinary domain of the civil courts are prescribed.

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In doing so, the SC has expressly overruled several of its previous judgments, viz. (i) *HDFC Bank Ltd. v. Satpal Singh Bakshi*^[5] to hold that matters covered under The Recovery of Debts due to Banks and Financial Institutions Act, 1993 (“DRT Act”) are non-arbitrable, otherwise banks and financial institutions covered under the DRT Act would be deprived and denied of the specific rights including the modes of recovery specified in the DRT Act; (ii) *N. Radhakrishnan v. Maestro Engineers & Ors.*^[6] observing that allegations of fraud can be made a subject matter of arbitration when they relate to a civil dispute; and (iii) *Himangni Enterprises* to hold that landlord-tenant disputes are arbitrable as the Transfer of Property Act does not forbid or foreclose arbitration. However, landlord-tenant disputes covered and governed by rent control legislation would not be 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 be adjudicated and enforced by the specified court / forum, and not through arbitration.

Who decides on non-arbitrability?

Having laid down broad guidelines that must be used to determine subject matter arbitrability, the SC has also attempted to definitively lay down the legal problem of allocation of decision making authority between court and arbitral tribunals.

The issue of non-arbitrability can be raised at three stages – (i) before the court on an application for appointment of arbitrator^[7] or stay of judicial proceedings and reference^[8]; (ii) before the arbitral tribunal during the course of arbitration proceedings; or (iii) before the court at the stage of challenge to the award or its enforcement – and thus the conundrum – Who decides on non-arbitrability?

Reiterating the principles laid down in *Garware Wall Ropes and Duro Felguera*^[9], whilst simultaneously placing heavy reliance on *Boghara Polyfab*^[10] the SC has answered the conundrum as follows –

1. The scope of judicial review under Section 8 and 11 of the Arbitration Act is identical but extremely limited and restricted.

2. The Arbitral Tribunal is the preferred first authority to determine and decide all questions of non-arbitrability. The Court has been conferred a power of 'second-look' on aspects of non-arbitrability post the award^[11].
3. Rarely, as a demurrer, the Court may interfere at the Section 8 or 11 stage when it is manifestly and *ex facie* certain that the arbitration agreement is non-existent, invalid or the disputes are non-arbitrable.

The SC has attempted to promote a pro-arbitration regime and it is on the lower Courts to ensure caution in exercising authority over proceedings referred to it under the Arbitration Act, and endeavour to refer matters to arbitration.

Conclusion

Vidya Drolia promises to be the next in a long line of judgments that will form the basis of law in arbitration post the 2019 Amendment to the Arbitration and Conciliation Act, 1996. The SC itself has already set the ball rolling in this regard by relying on *Vidya Drolia* even in matters of international commercial arbitration, and recently referring landlord-tenant disputes under the Transfer of Property Act, 1882 (and not protected by special rent control legislation) to arbitration.^[12]

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However, owing to Section 41 (1) of Presidency Small Cause Courts Act, 1882 (as amended in Maharashtra)^[13] it would appear that scope of *Vidya Drolia* is subject to a caveat and would not apply to landlord-tenant / licensor-licensee disputes arising in Mumbai where exclusive jurisdiction is conferred on the Small Causes Court by the special statute.

[1] Civil Appeal No.2402 of 2019 decided by the Supreme Court of India on 14 December 2020.

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

[3] Garware Wall Ropes Ltd. v. Coastal Marine Construction & Engineering Ltd., (2019) 9 SCC 209.

[4] Himangni Enterprises v. Kamaljeet Singh Ahluwalia, (2017) 10 SCC 706.

[5] 2013 (134) DRJ 566 (FB).

[6] (2010) 1 SCC 72.

[7] Under Section 11 of the Arbitration and Conciliation Act, 1996 – Appointment of arbitrators.

[8] Under Section 8 of the Arbitration and Conciliation Act, 1996 – Power to refer parties to arbitration where there is an arbitration agreement.

[9] Duro Felguera, S.A v. Gangavaram Port Ltd., (2017) 9 SCC 729.

[10] National Insurance Co. Ltd. v. Boghara Polyfab Pvt. Ltd., (2009) 1 SCC 267.

[11] Under Section 34 of the Arbitration and Conciliation Act, 1996 – Application for setting aside arbitral award.

[12] Suresh Shah v. Hipad Technology India Pvt. Ltd., Arbitration Petition (Civil) No. 8 of 2020, decided by the Supreme Court of India on 18 December 2020.

[13] Section 41 – Suits or proceedings between licensors and licensees or landlords and tenants for recovery of possession of immovable property and licence fees or rent, except to those to which other Acts apply to lie in Small Cause Court. – (1) Notwithstanding anything contained elsewhere in this Act or in any other law for the time being in force, but subject to the provisions of Sub-section (2), the Court of Small Causes shall have jurisdiction to entertain and try all suits and proceedings between a licensor and licensee, or a landlord and tenant relating the recovery of possession of any immovable property situated in Greater Bombay, or relating to the recovery of the licence fee or charges or rent therefor, irrespective of the value of the subject-matter of such suits or proceedings.

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