

Supreme Court on Arbitrability of Disputes

28 December 2020

This analysis covers:

1	Background	2
2	Facts	2
3	Court Ruling	3
4	Conclusion	4

1 Background

A three-judge bench of the Supreme Court of India in a landmark decision in the case of *Vidya Drolia v. Durga Trading Corporation* (**Vidya Drolia**), answered the question on whether landlord-tenant disputes governed by the Transfer of Property Act, 1882 (**TOPA**) are arbitrable. This question was referred to the three-judge bench by an order of the Supreme Court's division bench in *Vidya Drolia and Others v. Durga Trading Corporation* (**Vidya Drolia I**). The Supreme Court while delivering its judgement on the reference also laid down the law on arbitrability of disputes generally and the forum to decide upon the question of 'non-arbitrability' of a dispute. In *Vidya Drolia I*, the Supreme Court had questioned the reasoning rendered in *Himangni Enterprises v. Kamaljeet Singh Ahluwalia* (**Himangni**), which held that disputes governed by the TOPA were not arbitrable as a matter of public policy and referred the question to a larger bench of the Supreme Court.

In a landmark decision on the arbitrability of tenancy disputes, the Supreme Court held that landlord-tenant disputes (outside of Rent Control laws) are arbitrable. The Court also laid down the law on arbitrability of disputes generally and examined the jurisdiction of courts to decide arbitrability under Section 8 and Section 11 of the Arbitration and Conciliation Act, 1996.

2 Facts

Briefly, the timeline leading up to this reference is:

- a. In 1981, in *Natraj Studios (P) Limited v. Navrang Studios* (**Natraj**), the Supreme Court dismissed an application for appointing an arbitrator under Section 8 of the erstwhile Arbitration Act, 1940, on the ground that the tenancy was protected under the Rent Control Act and the relevant court stipulated under that statute alone had jurisdiction.
- b. In 2011, in *Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd.* (**Booz Allen**), the Supreme Court agreed and held that for eviction or tenancy matters governed by special statutes, where the tenant enjoys statutory protection, only the specified court has jurisdiction. *Booz Allen* also laid down the principle that rights *in rem* are not arbitrable, but subordinate rights, which are *in personam*, are arbitrable. The Supreme Court explained that a right *in rem* was exercisable against the world at large (example, testamentary matters), as contrasted from a right *in personam* which is an interest protected solely against specific individuals. Example, rights under a patent licence may be arbitrated, but the validity of the underlying patent may not be arbitrated. This became the guiding principle on arbitrability of disputes.
- c. In 2017, while relying on *Natraj* and *Booz Allen*, the Supreme Court in the *Himangni* case, went a step further to hold that even in cases where the TOPA was applicable, it would be the civil court which would have jurisdiction to decide landlord-tenant disputes and not an arbitrator.
- d. In 2019, the reasoning in *Himangni* was questioned by the Supreme Court in *Vidya Drolia I* while hearing a petition filed for appointment of an arbitrator under Section 11 of the Arbitration and Conciliation Act, 1996 (**Arbitration Act**). The two issues considered by the Supreme Court were - first, that the court should examine only the 'existence of an arbitration agreement' while appointing an arbitrator and not delve into

issues or arbitrability of the dispute. Second, that the TOPA does not preclude the arbitrability of landlord-tenant disputes, being rights *in personam*.

3 Court Ruling

The Supreme Court, while answering the reference, has held as follows:

- a. **Landlord-Tenant Disputes are arbitrable:** The Supreme Court overruled *Himangni* and found that landlord-tenant disputes are not actions *in rem* but pertain to subordinate rights *in personam*. The Supreme Court also noted that TOPA does not contain a bar against arbitration. Therefore, the court held that landlord-tenant disputes are arbitrable. The Supreme Court also carved out an exception where landlord-tenant disputes are governed by rent control legislation where specific courts have been designated to exclusively hear disputes. In such cases, disputes would not be arbitrable.
- b. **Meaning of non-arbitrability of a dispute:** The Supreme Court examined the meaning of non-arbitrability of disputes. After a detailed examination of various decisions, the Supreme Court formulated a 4-pronged test to determine when a dispute is non-arbitrable as under:
 - i. when the cause of action and subject matter of the dispute are related to a right *in rem*. Example, a right in copyright.
 - ii. when cause of action and subject matter of the dispute affect third party rights or where they operate against the world in general. Example, matters relating to probate, testamentary matter etc.
 - iii. when cause of action and subject matter of the dispute relate to inalienable sovereign and public interest functions of the State. Example, monopoly rights granted by a State.
 - iv. when the subject-matter of the dispute is expressly or by necessary implication non-arbitrable as per mandatory statutes since Section 2(3) (Scope) of the Arbitration Act itself recognises that certain disputes may not be referred to arbitration. Example, disputes between workmen and management under the Industrial Disputes Act, 1947 (**ID Act**) are required to be exclusively adjudicated by authorities constituted under the ID Act.

While laying down the above test, the Supreme Court overruled its 2010 decision in *N. Radhakrishnan v. Maestro Engineers and Others*, which held that matters of fraud were not arbitrable. By doing so, the Supreme Court has cemented the judicial shift towards arbitrability of allegations of fraud in contractual disputes.

The Supreme Court also overruled a 2013 decision of a full bench of the Delhi High Court in *HDFC Bank Limited v. Satpal Singh Bakshi*, which held that disputes between banks and lenders under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 were arbitrable. Thus, the Supreme Court has now laid down that disputes to be adjudicated by the Debts Recovery Tribunal (**DRT**) are not arbitrable.

- c. **Forum to decide upon non-arbitrability:** The Supreme Court examined in detail as to which of the following forums can and should determine arbitrability:
 - a court or judicial authority under Section 8 of the Arbitration Act (Power to refer parties to arbitration where there is an arbitration agreement),
 - the Chief Justice or his designate under Section 11 of the Arbitration Act (Appointment of arbitrators),
or

ANALYSIS

- the arbitral tribunal in exercise of powers under Section 16 of the Arbitration Act (Competence of arbitral tribunal to rule on its jurisdiction).

The Court's findings on this were as follows.

- i. The scope of judicial review and jurisdiction of the court under Section 8 and 11 of the Arbitration Act is identical but extremely limited and restricted.
- ii. The general rule is that the arbitral tribunal is the preferred first authority to decide all questions of arbitrability. Courts may have a second look in challenge proceedings.
- iii. Courts will rarely interfere at the Section 8 or 11 stage and will only do so when it is manifest that the arbitration agreement is non-existent, invalid or the disputes are non-arbitrable.
- iv. Where the facts are contested or inconclusive, courts should allow the tribunal to decide. Courts should not enter into a mini trial or elaborate review so as to usurp the jurisdiction of the arbitral tribunal.

4 Conclusion

The decision brings clarity on arbitrability of landlord-tenant disputes and on arbitrability of various disputes in general. However, the Supreme Court has slightly expanded the scope of review under Section 11 of the Arbitration Act under the rare 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). It remains to be seen how Section 11 matters will play out in courts.

If you require any further information about the material contained in this newsletter, please get in touch with your Trilegal relationship partner or send an email to alerts@trilegal.com. The contents of this newsletter are intended for informational purposes only and are not in the nature of a legal opinion. Readers are encouraged to seek legal counsel prior to acting upon any of the information provided herein.