ELP Arbitration: Update

SUPREME COURT ON ARBITRABILITY OF DISPUTES GOVERNED BY THE TRANSFER OF PROPERTY ACT … AND A LOT MORE

Vidya Drolia and Others v. Durga Trading Corporation.[1] *(December 14, 2020) (Durga Trading)*

BACKGROUND

- A reference was made to a three-judge bench of the Supreme Court by a two judge bench of the Supreme Court in *Vidya Drolia*[2] which had held that disputes governed by provisions of the Transfer of Property Act, 1882 (**TPA**) were arbitrable and in doing so had taken a different view from an earlier decision of a coordinate bench of the Supreme Court in *Himangni Enterprises*[3]*.*

- In *Vidya Drolia*[4]*,* the Supreme Court had observed that in reaching its conclusion in *Himangni Enterprises,* its coordinate bench misplaced its reliance on *Natraj Studios*[5] and *Booz Allen*[6]. According to *Vidya Drolia*, the decision in *Natraj Studios* was arrived at in the context of a dispute arising from a lease deed under the Bombay Rents Act, 1947, which was a special statute and had a specified separate forum for adjudication (i.e. the Small Causes Court). On the other hand, *Booz Allen* carved out exceptions to arbitrate such as - tenancy matters that were governed by a special statute, matters which provided statutory protection against eviction, and matters where jurisdiction was vested only in a special forum. As the issues in *Himangni Enterprises* and *Vidya Drolia* stemmed from the TPA and were therefore, neither governed by any special statute nor by the exceptions set out in *Booz Allen*, the two-judge bench in *Vidya Drolia* held that disputes governed by the TPA were arbitrable. Owing to the conflicting decisions, the judges in *Vidya Drolia* referred the issue to a larger bench in *Durga Trading*.

---

[1] 2020 SCC OnLine SC 1018;
[2] *Vidya Drolia v. Durga Trading Corporation*, 2019 SCC OnLine SC 358
[3] *Himangni Enterprises v. Kamaljeet Singh Ahluwalia*, (2017) 10 SCC 706
[4] *Vidya Drolia v. Durga Trading Corporation*, 2019 SCC OnLine SC 358
[5] *Natraj Studios (P) Ltd. v. Navrang Studios*, (1981) 1 SCC 523
[6] *Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd*, (2011) 5 SCC 532 : (2011) 2 SCC (Civ) 781

© Economic Laws Practice 2020

ISSUES

- In *Durga Trading*[7], the Supreme Court chalked out two primary issues for consideration:
  - The meaning of non-arbitrability and when the subject matter of the dispute is not capable of being resolved through arbitration; and
  - "Who decides" - Whether the court at the reference stage or the arbitral tribunal in the arbitration proceedings would decide the question of non-arbitrability.
- At this juncture, it is relevant to mention that *Himangni Enterprises* arose from an application under section 8 of the Arbitration and Conciliation Act, 1996 (**Arbitration Act**) which mandates that a judicial authority, before which an action is brought in a matter which is the subject of an arbitration agreement shall refer the parties to arbitration unless it finds that prima facie no valid arbitration agreement exists. *Vidya Drolia*[8] on the other hand, arose from an application under section 11 of the Arbitration Act, i.e. where failing the agreed mechanism for appointment of an arbitrator/tribunal, a court is approached for the appointment of an arbitrator. Therefore, the Supreme Court also considered the scope of the court's jurisdiction when an objection of non-arbitrability is raised in an application under Section 8 or 11 of Arbitration Act.

FINDINGS AND OBSERVATIONS

Four-fold test to determine the arbitrability of the subject matter of dispute

- The Supreme Court examined the submissions, jurisprudence, and evolution of statutory provisions. Based on the same, the Supreme Court laid down a fourfold test to determine when the subject matter of a dispute in an arbitration agreement is not arbitrable:
  - When 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*.
  - When 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;
  - When 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
  - When the subject-matter of the dispute is expressly or by necessary implication non-arbitrable as per mandatory statute(s).
- Relying upon *Olympus Superstructures*[9] , the Supreme Court observed that the above tests ought to be applied with care. The Supreme Court cautioned that while the tests are *"not watertight compartments*; *they dovetail and overlap*". Only when the answer to the above parameters is in the affirmative, the subject matter of the dispute would be non-arbitrable.

Disputes governed by the provisions of the Transfer of Property Act are arbitrable

- Applying the four-fold test in context of the TPA, the Supreme Court held that
  - Landlord-tenant disputes governed by the TPA are arbitrable as they are not actions *in rem* but pertain to subordinate rights *in personam* that arise from rights *in rem*. Such actions normally would not affect third-party rights or have *erga omnes* affect or require centralized adjudication;
  - An arbitral award deciding landlord-tenant disputes can be executed and enforced like a decree of the civil court;
  - Landlord-tenant disputes do not relate to inalienable and sovereign functions of the State;
  - The provisions of TPA do not expressly or by necessary implication bar arbitration;

---

[7] Civil Appeal No. 2402 of 2019, Special Leave Petition (Civil) Nos. 5605-5606 of 2019 and Special Leave Petition No. 11877 of 2020
[8] *Vidya Drolia v. Durga Trading Corporation*, 2019 SCC OnLine SC 358
[9] *Olympus Superstructures Pvt. Ltd. v. Meena Vijay Khetan*, (1999) 5 SCC 651

- Further, TPA like all other Acts, has a public purpose, that is, to regulate landlord-tenant relationships and the arbitrator would be bound by the provisions, including provisions which ensure and protect the tenants.

- Thus, the Supreme Court overruled the ratio laid down in *Himangni Enterprises* and held that "*landlord-tenant disputes are arbitrable as the TPA does not forbid or foreclose arbitration".*

- The Supreme Court caveated that 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 (expressly or implicitly) to apply and decide special rights and obligations, which rights and obligations can only be adjudicated and enforced by the specified court/forum, and not through arbitration.

Arbitrability in other circumstances

- Applying the tests to determine non-arbitrability, the Supreme Court observed that insolvency or intracompany disputes have to be addressed by a centralized forum i.e. the court or a special forum, which has complete jurisdiction to efficaciously dispose of the entire matter. They are actions in rem. Thus, the Supreme Court concluded that disputes which are to be adjudicated by the Debt Recovery Tribunal are also rendered non-arbitrable. Hence, the Supreme Court overruled the full bench decision of the Delhi High Court *Hdfc Bank Ltd. vs Satpal Singh Bakshi*[10].

- Applying the tests to determine non-arbitrability of disputes governed by certain other legislations, summarily, the Supreme Court held as follows:

Nature of Dispute	Finding
Grant/issue of patents and registration of trademarks	Not arbitrable However, if there are issues pertaining to subordinate rights *in personam*, for example, rights under a patent license, these may be arbitrable
Criminal matters	Not arbitrable
Matrimonial disputes such as dissolution of marriage and restitution of conjugal rights	Not arbitrable
Matters pertaining to probate, testamentary matters, etc.	Not arbitrable

Arbitrability where there are allegations of fraud

- In *N. Radhakrishnan*[11] *,* Supreme Court had observed that the appellant had made serious allegations of fraud and malpractices which could not be properly determined by an arbitrator. Disagreeing with the ratio of this case and concurring with its decision in *Avitel*[12], the Supreme Court overruled the ratio in *N. Radhakrishnan inter alia* observing that allegations of fraud can be made a subject matter of arbitration when they relate to a civil dispute. This was subject to the caveat that fraud, which would vitiate and invalidate the arbitration clause, is an aspect relating to non - arbitrability.

Who shall decide the issue of non-arbitrability – the court or the tribunal?

- The Supreme Court observed that the question would arise at the below three stages:

[10] *HDFC Bank Ltd. v. Satpal Singh Bakshi, (2013) 134 DRJ 566 (FB)*
[11] *N. Radhakrishnan* v. *Maestro Engineers,* (2010) 1 SCC 72
[12] *Avitel Post Studioz Ltd. v. HSBC PI Holdings (Mauritius) Ltd.*, Civil Appeal No. 5145 of 2016 and connected matters, decided on 19.08.2020

© Economic Laws Practice 2020

- Before the court in an application under Section 11 of the Arbitration Act or for stay of pending judicial proceedings and reference under Section 8 of the Arbitration Act;
- Before the arbitral tribunal during the arbitration proceedings; or
- Before the court at the stage of the challenge to the award or its enforcement.

- The Supreme Court then embarked upon the threshold of enquiry under Section 11 and Section 8 of the Arbitration Act, i.e. the 'first look stage'. While there is a lot to be discussed on seemingly conflicting observations in the dicta of the Supreme Court, the uncontestable takeaways are as under:
  - The law on the scope of enquiry has been amended by the Arbitration and Conciliation (Amendment) Act, 2015 (**2015 Amendment Act**)
  - In view of the legislative mandate in the 2015 Amendment Act and the Arbitration and Conciliation (Amendment) Act, 2019 (**2019 Amendment Act**), and in view of the principle of severability and *kompetenz-kompetenz*, the arbitral tribunal is the preferred first authority to determine and decide all questions of non-arbitrability
  - The court may rarely interfere at the Section 8 or 11 stage when it is manifestly and ex facie certain that the arbitration agreement is nonexistent, invalid or the disputes are non-arbitrable, though the nature and facet of non-arbitrability would, to some extent, determine the level and nature of judicial scrutiny. The restricted review is to protect parties from being forced to arbitrate when the matter is demonstrably 'non-arbitrable' and to cut off the deadwood.
  - Scope of judicial review and jurisdiction of the court under Sections 8 and 11 of the Arbitration Act is identical but extremely limited and restricted
  - Existence of an arbitration agreement presupposes a valid agreement which would be enforced by the court by relegating the parties to arbitration. Thus, existence and validity are intertwined, and arbitration agreement does not exist if it is illegal or does not satisfy mandatory legal requirements. Hence, the omission of the word '*valid*' in Section 11(6A) of the Arbitration Act does not curtail the court's power to examine the issue of arbitrability at the threshold
  - Courts at referral stage perform judicial and not ministerial functions
  - Enquiry into arbitrability has to be on a *prima facie* basis. Referral court would relegate parties to arbitration unless there are good and substantial reasons to the contrary.
  - *Prima facie* examination is not full review but a primary first review to weed out manifestly and *ex facie* non-existent and invalid arbitration agreements and non-arbitrable disputes. The *prima facie* review at the reference stage is to cut the deadwood when on the facts and law, the litigation must stop at the first stage. The court cannot get lost in the thickets and decided debateable questions of facts
  - Referral proceedings are summary and not a mini trial
  - There must be a plainly arguable case against referring parties to arbitration. *'When in doubt, do refer'*
  - Absolute hands-off approach is counterproductive. The legal order needs a right balance between avoiding arbitration obstructing tactics at referral stage and protecting parties from being forced to arbitrate when the matter is clearly non-arbitrable
  - There is no particular approach to be adopted while construing/interpreting an arbitration agreement. However, in cases of pure commercial disputes, a liberal construction in line with a presumption in favor of a one-stop adjudication may be adopted.

- Interestingly, in a separate but concurring judgment in the *Durga Trading*, the Ld. Judge *inter alia* held that to examine the *prima facie* validity of an arbitration agreement, the following questions ought to be considered - (a) whether the arbitration agreement was in writing?; or (b) whether the arbitration agreement was contained in exchange of letters, telecommunication etc.?; (c) whether the core contractual ingredients qua the arbitration agreement were fulfilled? (d) on rare occasions, whether the subject-matter of dispute is arbitrable?

© Economic Laws Practice 2020

CONCLUSION AND ANALYSIS

- While one is quick to critique any decision, it is praiseworthy that the Supreme Court has laid to rest the controversy around the arbitrability of disputes governed by the provisions of TPA and also on those governed by special statutes pertaining to tenancy matters. Yet, one does wonder - if in the preparation of this main course, the Supreme Court has in fact created astringent appetizers.
- For instance, in its observation that *"it is apparent that insolvency or intracompany disputes have to be addressed by a centralized forum, be the court or a special forum, which would be more efficient and has complete jurisdiction to efficaciously and fully dispose of the entire matter. They are also actions in rem"* has the Supreme Court shut the door on arbitrability of such disputes? It may be noteworthy that there are various intracompany disputes which may very well be capable of arbitration and need not involve an action *in rem*. Further, the Supreme Court has also ruled in the negative on the arbitrability of disputes that can be adjudicated by the DRT. Leaving aside for the moment the caseload that had crippled the DRT, which will now increase by leaps and bounds, it was quite evident that arbitration was being consciously elected despite the availability of a wider set of reliefs from the DRT. Also, transactions which are below the monetary threshold of the DRT may continue to be arbitrable, which itself seems incongruous.
- Although, the Supreme Court has repeatedly emphasized the *prima facie* nature of review at the referral stage, a combination of factors seems to have increased the scope of enquiry. Firstly, the finding that validity of the arbitration agreement can be looked into. Secondly, that there seems to be an acceptance of the position as adopted in *Boghara Polyfab*[13] of matters that must compulsorily be investigated by the court, matters that may be investigated by the court and matters that ought not to be looked into by the court at the referral stage. This can result in issues of limitation, excepted matters, accord satisfaction, novation, etc. being decided at the threshold. This is perplexing, given that the Supreme Court itself accepts that the law has changed post the 2015 Amendment Act. Third, that despite the repeated caution of a *prima facie* examination, there was a conscious discussion around the term *examination* and the observation that *'the court may for legitimate reasons, to prevent wastage of public and private resources, can exercise judicial discretion to conduct an intense yet summary prima facie review while remaining conscious that it is to assist the arbitration procedure and not usurp jurisdiction of the arbitral tribunal'*.
- Needless to state, the introduction of section 11 (6-A) by the 2015 Amendment Act (now deleted by the 2019 Amendment Act) had brought about remarkable progress as the scope of courts were confined to *"examine the existence of an arbitration agreement"* at the section 11 stage. The present decision may have inadvertently stretched the scope of enquiry at the referral stage back to the pre-2015 position. Perhaps the entire essence of this decision lies not in the ballad but in the haiku, *'When in doubt, do refer.'*

Disclaimer: *The information provided in this update is intended for informational purposes only and does not constitute legal opinion or advice. Readers are requested to seek formal legal advice prior to acting upon any of the information provided herein. This update is not intended to address the circumstances of any particular individual or corporate body. There can be no assurance that the judicial/quasi-judicial authorities may not take a position contrary to the views mentioned herein.*

[13] *National Insurance Company Ltd. v Boghara Polyfab Pvt. Ltd.* (2009) 1 SCC 267

© Economic Laws Practice 2020