

Supreme Court of India Clarifies 'What is Arbitrable' under Indian Law and Provides Guidance to Forums in Addressing the Question

In the recent spate of amendments to the Arbitration & Conciliation Act, 1996 (the “**Arbitration Act**”), one issue remained overlooked – whether a particular dispute can be referred to arbitration or whether such dispute is exclusively reserved for adjudication by a court. A likely reason for this is the absence of an express provision in the Arbitration Act. Section 2(3) of the Arbitration Act provides that “*certain disputes may not be submitted to arbitration*”. Further, Sections 34(2)(b) and 48(2) provide for setting aside and refusal to enforce an arbitral award if “*the subject-matter of the dispute is not capable of settlement by arbitration under the law*”. Therefore, this question appears to have been left to the interpretative mandate of the Indian judiciary, at times leading to divergent rulings.

In a recent judgment, the Supreme Court of India (the “**Supreme Court**”) in *Vidya Drolia & Others v. Durga Trading Corporation*¹ (“**Vidya Drolia**”) has made an attempt to clear the decade-old uncertainty on this issue and has proposed a four-fold test to determine the question of arbitrability in India along with an interpretative guide for forums adjudicating this issue.

This article briefly discusses the position of law prior to the judgment in *Vidya Drolia* and then goes on to discuss the key findings of the Supreme Court in *Vidya Drolia* and the application of the test and guidance to forums.

ARBITRABILITY UNDER INDIAN LAW: THE PRE-VIDYA DROLIA ERA

The Supreme Court’s 2011 judgment in *Booz Allen and Hamilton Inc v. SBI Home Finance Ltd. & Others*² (“**Booz-Allen**”) forms the foundation for any discussion on the question of arbitrability in India as it laid down a test for determining whether a subject-

¹ *Vidya Drolia & Others v. Durga Trading Corporation*, 2019 SCCOnLine SC 358.

² *Booz Allen and Hamilton Inc v. SBI Home Finance Ltd. & Others*, (2011) 5 SCC 532.

matter of a dispute is capable of arbitration in India or not (the “**Booz-Allen Test**”). In *Booz-Allen*, the Supreme Court observed that the question of arbitrability is to be decided on the basis of the ‘nature of rights’ involved in the dispute. If the dispute involves a right *in rem*, i.e., a person’s right against the world at large, the dispute is not arbitrable. On the other hand, if a dispute involves a right *in personam*, i.e., rights against specific individuals, such as in a contract, the dispute is arbitrable. The Supreme Court applied the test and carved out a list of six categories of disputes that are not arbitrable: (1) disputes which give rise to or arise out of criminal offences; (2) matrimonial disputes, (3) guardianship matters; (4) insolvency and winding up matters; (5) testamentary matters; and (6) eviction or tenancy matters.

The Booz-Allen Test supplemented the earlier Supreme Court decision in *Sukanya Holdings Private Ltd. v. Jayesh H. Pandya and Another*³ where it held that where claims cannot be bifurcated into arbitrable and non-arbitrable claims and if a non-arbitrable claim exists, the arbitrable claim cannot be arbitrated as well.

The Booz-Allen Test of arbitrability was examined by the Supreme Court in the context of allegations of fraud in *A. Ayyasamy v. A. Paramasivam and Others*⁴ (“**Ayyasamy**”) where it held that, if the jurisdiction of the ordinary civil court is excluded by the conferment of exclusive jurisdiction on a specified/special court or tribunal then such a dispute would not be capable of resolution by arbitration as a matter of public policy. Further, in *Ayyasamy*, the Supreme Court had ruled that mere allegations of fraud, which touch upon the internal affairs of the party and has no implication in the public domain, cannot oust the jurisdiction of an arbitral tribunal. However, serious allegations of fraud would render the dispute non-arbitrable which would have to be adjudicated only by a court.

In 2016, the Supreme Court added a seventh category to the list of disputes that could not be arbitrated – disputes arising out of a trust deed under the Indian Trust Act, 1882. The Supreme Court in *Shri Vimal Kishor Shah v. Jayesh Dinesh Shah & Others*⁵ (“**Vimal Kishor Shah**”) evaluated the scheme of the Indian Trusts Act, 1882 (“**Trusts Act**”) and noted that the Trusts Act functioned like a complete code in itself with the legal remedies available to the author, trustees and beneficiaries specifically conferred upon a principal civil court of original jurisdiction. In its decision, the Supreme Court relied on its Constitution Bench decision in *Dhulabhai and Others v. State of Madhya Pradesh*⁶, which laid down principles for determining express and/or implied bar on the

³ *Sukanya Holdings Private Ltd. v. Jayesh H. Pandya and Another*, (2003) 5 SCC 531.

⁴ *A. Ayyasamy v. A. Paramasivam and Others*, (2016) 10 SCC 386.

⁵ *Shri Vimal Kishor Shah v. Jayesh Dinesh Shah & Others*, (2016) 8 SCC 788.

⁶ *Dhulabhai and Others v. State of Madhya Pradesh*, AIR 1969 SC 78.

jurisdiction of civil courts, to rule that since the Trusts Act provided a specific remedy for adjudication of disputes by a civil court, the remedy of arbitration was impliedly barred.

Therefore, pre- *Vidya Drolia*, the position of law on arbitrability of disputes was centered on two principles: first, the 'nature of rights' principle which lays down seven categories of disputes as noted by the Supreme Court; and second, the 'exclusive forum of adjudication' principle which bars disputes under legislations vesting exclusive jurisdiction upon specific/special forums or tribunals from being resolved through arbitration.

VIDYA DROLIA AND THE NEW FOUR-FOLD TEST TO DETERMINE ARBITRABILITY IN INDIA

In *Vidya Drolia*, a three judge bench of the Supreme Court was answering a reference made by a two judge bench of the Supreme Court which was deciding an appeal against a Calcutta High Court order appointing an arbitrator in a dispute between a landlord and tenant under Section 11 of the Arbitration Act. Although the order of reference was confined to the question of whether tenancy disputes are arbitrable, given the lack of clarity on this issue, the Supreme Court found it appropriate to review the position of Indian law on arbitrability and examined the concept of arbitrability in other jurisdictions. The Supreme Court has now propounded a four-fold test to determine when a subject-matter is not arbitrable.

The Supreme Court in *Vidya Drolia* held, disputes are not arbitrable when the cause of action and/or subject-matter of the dispute:

1. relates to actions *in rem*, that do not pertain to subordinate rights *in personam* that arise from rights *in rem*;
2. affects third party rights, have *erga omnes* effect, require centralized adjudication, and mutual adjudication would not be appropriate;
3. relates to inalienable sovereign and public interest functions of the State; and
4. is expressly or by necessary implication non-arbitrable under a specific statute.

An affirmative answer in respect to any of the above would render the dispute non-arbitrable. The Supreme Court clarified that although these tests are not "watertight compartments", they would assist greatly in determining when a particular subject-matter would be non-arbitrable under Indian law.

By applying the aforesaid tests, the Supreme Court went on to expressly overrule: (1) its 2010 judgment in *N. Radhakrishnan v. Maestro Engineers*⁷ and held that allegations of fraud in a civil dispute are arbitrable; (2) the Delhi High Court's 2012 judgment in *HDFC Bank Ltd. v. Satpal Singh Bakshi*⁸ holding that disputes falling under the jurisdiction of the Debt Recovery Tribunal created under the Recovery of Debts Due to Banks & Financial Institutions Act, 1993 are non-arbitrable; and (3) its 2017 judgment in *Himangni Enterprises v. Kamaljeet Singh Ahluwalia*⁹ to hold that tenancy disputes under the Transfer of Property Act, 1882 ("**Transfer of Property Act**") are arbitrable in as much as there is no exclusive jurisdiction vested in another specific forum to apply and decide any special rights and obligations.

In *Suresh Shah v. Hipad Technology India Private Limited*¹⁰, another three judge bench of the Supreme Court referred to the law laid down in *Vidya Drolia* and clarified why arbitrability of tenancy disputes is contingent on whether the lease agreement is governed by the Transfer of Property Act or by special statutes such as those relating to rent control. It stated that an arbitral tribunal's jurisdiction is limited to disputes concerning or arising from the terms and conditions of a lease agreement and only a court of competent jurisdiction is empowered to grant other statutory remedies provided in special statutes such as protection against eviction etc. Therefore, a tenancy dispute in respect of a property that is subject to rent control legislation is not arbitrable.

SUPREME COURT'S GUIDANCE TO FORUMS ON ADDRESSING THE ISSUE OF ARBITRABILITY

After deciding what subject matters cannot be made arbitrable, the Supreme Court turned to answer another crucial question – whether the court or the arbitral tribunal should decide arbitrability. It noted that a party could raise the issue of arbitrability at three stages: (1) before the court (reference to arbitration under Section 8 and appointment of arbitrator under Section 11 of the Arbitration Act); (2) before the arbitral tribunal during the course of the arbitral proceedings; and (3) before the court (under Sections 34 and 48 of the Arbitration Act). The Supreme Court observed that the legislative intent behind the 2015¹¹ and 2019¹² amendments to the Arbitration Act was to reinforce the notion that the arbitral tribunal is the "preferred first authority" to

⁷ *N. Radhakrishnan v. Maestro Engineers*, (2010) 1 SCC 72.

⁸ *HDFC Bank Ltd. v. Satpal Singh Bakshi*, (2013) 134 D.R.J. 556.

⁹ *Himangni Enterprises v. Kamaljeet Singh Ahluwalia*, (2017) 10 SCC 706.

¹⁰ *Suresh Shah v. Hipad Technology India Private Limited*, 2020 SCCOnLine 1038.

¹¹ Arbitration and Conciliation (Amendment) Act, 2015, No. 3 of 2016.

¹² Arbitration and Conciliation (Amendment) Act, 2019, No. 33 of 2019.

adjudicate all questions relating to arbitrability and courts are to only have a ‘second look’ at the award under Section 34 of the Arbitration Act. It clarified that the permitted scope of interference under Sections 8 and 11 of the Arbitration Act is identical and is to only decide the question of arbitrability when it is manifestly and *ex facie* certain that the arbitration agreement is non-existent or invalid or the subject-matter is non-arbitrable. Therefore, it clarified that the courts could intervene to adjudicate on this issue only when the subject-matter is “demonstrably non-arbitrable”. The Supreme Court referred to this rule as “*when in doubt, do refer [to the arbitral tribunal]*”.

The Supreme Court further clarified that a court’s power to intervene under the Arbitration Act is only limited to an examination of *prima facie* validity of the arbitration agreement which includes (1) the form of the arbitration agreement – whether it is in writing, or whether it is contained in an exchange of letters, telecommunication etc.; and (2) whether it fulfills the core contractual requirements under Indian law. Only in rare cases does the court have the power to examine arbitrability of a dispute.

CONCLUSION

The judgment in *Vidya Drolia* is a welcome development in the progress of arbitration in India. The Supreme Court’s interpretation on the permitted scope of interference by courts in deciding arbitrability is also notable and offers clear guidance to courts while deciding this question. One could criticize the Supreme Court’s passing remark on the question of arbitrability of ‘intra-company’ disputes. That term is not clarified in the judgment and presumably was not meant to refer to shareholder disputes which have historically been referred to arbitration and should be read in conjunction with the prior reference to “insolvency” and a similar class of proceedings. Having said that, it remains to be seen how courts implement the test and guidance laid down by the Supreme Court in *Vidya Drolia*.

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