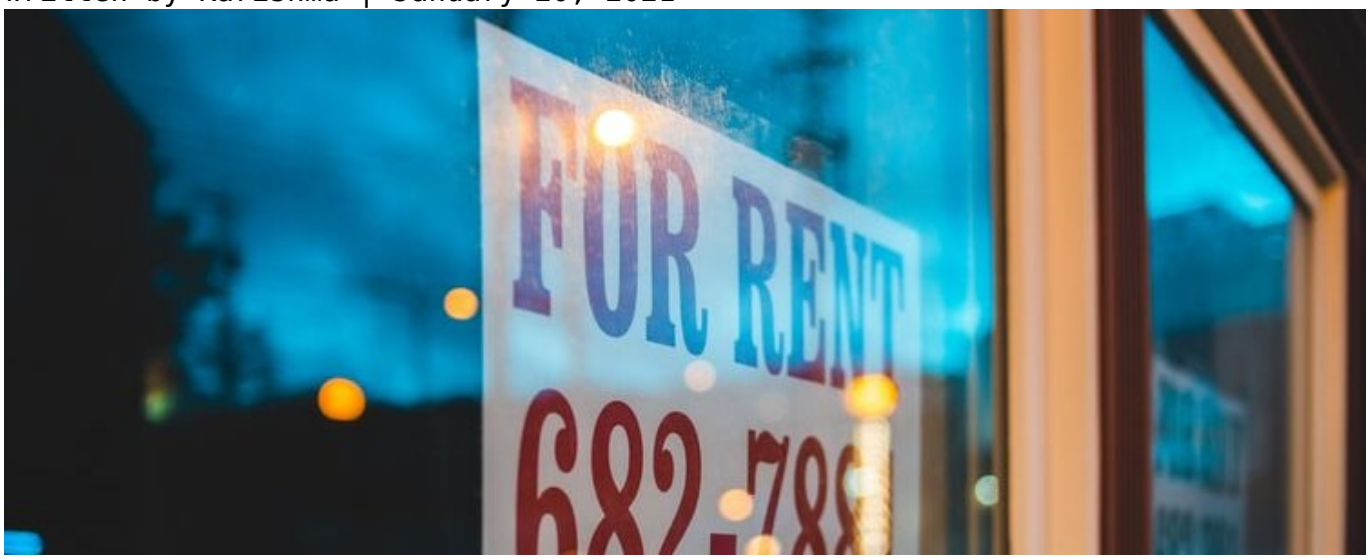
Vidya Drolia and the New Four Fold Test for Arbitrability
written by Karishma | January 20, 2021



Vidya Drolia and the Four Fold Test: The New Scope of Arbitrability of Tenancy Disputes

For decades, the courts of India have been the writers of the paradoxical saga of non – arbitrability of landlord-tenant disputes which seems to have seen an end by the recent Supreme Court Judgment in the case of *Vidya Drolia versus Durga Trading Corporation*[1]. A three-judge bench of the Supreme Court comprising of Hon'ble Justice N.V. Ramana, Justice Krishna Murari and Justice Sanjiv Khanna, on 14 December 2020, passed a judgment that overrules many of the Apex Court judgments along with various High Court judgments by upholding the arbitrability of tenancy disputes unless governed by special statutes and judicable by specific courts or forums.

The Journey So Far

Initially, the non-arbitrability of the tenancy disputes was upheld by the Supreme Court in the year 1981, in the judgment of Natraj Studios (P) Ltd vs Navrang Studios & Anr[2] wherein an application under Section 8 of the Arbitration and Conciliation Act 1940 was dismissed and the court held that *"since the disputes relating to tenancy were protected under the Bombay Rents, Hotel & Lodging Houses Rates control, 1947, scope of arbitration of lease disputes is ruled out."* The same ruling was upheld by the Apex Court in another judgment of Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd[3] that "*since the tenancy matters are governed under special statutes, only specific courts have exclusive jurisdiction to adjudicate*".

Thereafter, In Himangni Enterprises v. Kamaljeet Singh Ahluwalia[4], the Supreme Court further broadened the scope of non arbitrability of tenancy disputes and held that *"though the Delhi Rent Act is not applicable, it does not follow that the Arbitration Act would be applicable so as to confer jurisdiction on the arbitrator. Even in cases of tenancies governed by the Transfer of Property Act, the dispute would be triable by the civil court and not by the arbitrator."*

In the Vidya Drolia Judgment, the Court laid down fourfold test for determining when the subject matter of a dispute in an arbitration agreement is not arbitrable:

"(1) 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.

(2) 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;
(3) 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
(4) when the subject-matter of the dispute is expressly or by necessary implication non-arbitrable as per mandatory statute(s).”

Rights in Personam versus Rights in Rem

Right in rem is a right that can be exercised against the world at large, whereas in the case of rights in personam, an interest over property, person or subject matter is protected against a specific or definitive set of individuals. Similarly, a judgment in rem when passed protects rights in rem and binds all persons claiming an interest in the res (property), the status of which is determined by the court. In contrast, while passing a judgment in personam, the court merely determines the interests and rights of the litigants inter se to the res.

Generally, and traditionally the actions in rem are excluded from arbitration considering the limits of arbitration, which being an alternative dispute resolution mechanism chosen privately by parties, binds only the parties to the arbitration agreement. On the other hand, the adjudication by the courts established by law is mandatorily binding on all the parties by the rule of law and public policy and the conferring source of jurisdiction is not any mutual agreement.

The dispute resolution mechanism of arbitration is consensual and conceptual in nature and hence in disputes where the rights and liabilities of third parties who are not bound by the arbitration agreement are getting affected, resorting to arbitration would not be suitable. Based on the above ratio, the Supreme Court in the present judgment observed that landlord-tenant disputes do not involve rights in rem but deal with subordinate rights in personam which arise from rights in rem and hence are arbitrable.

The Transfer of Property Act, 1882 does not specifically bar tenancy disputes to be referred to arbitration neither does it confer exclusive jurisdiction to adjudicate tenancy disputes onto any special or determinate forum. Therefore, in furtherance of the legislative intent to protect and regulate the landlord-tenant relationship, arbitration can be mutually adopted by the parties as a dispute resolution mechanism.

Who Decides Arbitrability?

There is a difference between a non-arbitrable claim and a non-arbitrable subject matter. Determining the non-arbitrability of a claim would depend on the scope of the arbitration agreement and the nature of the claim if it is not capable of being resolved through arbitration. Whereas the non-arbitrability of the subject matter, generally, would mean non-arbitrability in law.

Another crucial aspect dealt with by the Supreme Court in Vidya Drolia Judgment is when the issue of determination of non-arbitrability of subject matter arises, who will be the deciding authority and at what stage and to what extent can it exercise its power. The Apex Court while addressing the issue of *“who must decide issues of arbitrability, and to what extent”* has bifurcated three stages at which the issue of non-arbitrability of a dispute may be raised:

1. *Referral Stage: Before a court or judicial authority under Sections 8 or 11 of the Arbitration Act;*
2. *Arbitration Stage: Before the arbitral tribunal; and*
3. *Challenge Stage: Before a court when an arbitral award is being challenged under Section 34*

On one hand, where the Arbitration Act itself empowers the arbitral tribunal to rule on all aspects of arbitrability at the Arbitration Stage, a second opinion by the courts is still open under Section 34 of the Arbitration Act when the validity of the arbitral award is brought for challenge. At the challenge stage, the courts are empowered under Section 34 (2) (b) (ii) of the Arbitration and Conciliation Act, 1996 to set aside an arbitral award for being in conflict with the public policy of India.

However, basing the argument of foregoing with the arbitration agreement in disputes when the public interest or public policy so demands on this provision would imply that the courts are considering arbitration as an inferior and compromised mechanism as compared to adjudication by courts. The Supreme Court in the present judgment has clarified by upholding that an arbitral award shall be set aside on the ground of public policy only when it is induced by fraud or is against the fundamental policy of Indian law or against the most basic notions of justice and morality.

For determination of arbitrability at the referral stage, the Apex Court has laid down guidance for forums instructing the courts to reject an application under Section 8 only when there is prima facie evidence that no valid arbitration agreement exists, or that the disputes are not arbitrable. In cases where the validity of the arbitration agreement cannot be determined on a prima facie basis, the courts must stick to the rule *"when in doubt, do refer"*.

Googlies hidden in the Decision of Certainty

Although the present judgment of the Supreme Court settles the uncertainty which persisted for decades on a number of crucial aspects of the arbitration, at the same time, it suffers from few loopholes which must be addressed immediately to save from its poisonous darts.

The judgment was pronounced as an overruling dictum against the decisions which upheld the arbitrability of matters covered under the Recovery of Debts and Bankruptcy Act (RDB Act), 1993 by concluding that since the Act provides for specific modes of recovery, the claims of banks and NBFCs which are covered under the scope of the Act shall be non-arbitrable. This finding of non arbitrability of claims which can be filed before the Debt Recovery Tribunals (DRT) can be a subject of conflicting interpretations and would affect thousands of arbitrations that are filed by banks and NBFCs.

There is nothing in the RDB Act, 1993 that prohibits reliefs by a tribunal appointed and empowered directly from a contract between banks and their customers. In fact, arbitration, on one hand, would resultantly be convenient and time saving for banks and NBFCs and on the other hand, would also reduce the burden on courts and tribunals. The court has failed to provide a reasonable clarification as to how claims of the same nature differentiated only on the basis of monetary limit (20 Lakh being the monetary limit of claim to approach the DRT), be treated differently on the question of arbitrability.

- [1] Vidya Drolia and Ors. vs. Durga Trading Corporation (14.12.2020 - SC Order) : MANU/SCOR/46012/2020

- [2] (1981) 1 SCC 523
- [3] (2011) 5 SCC 532
- [4] (2017) 10 SCC 706

Contributed By - Karishma, Associate
King Stubb & Kasiva,
Advocates & Attorneys
Click Here to Get in Touch
New Delhi | Mumbai | Bangalore | Chennai | Hyderabad | Kochi
Tel: +91 11 41032969 | Email: info@ksandk.com