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A False Start – Uncertainty in the Determination of Arbitrability in India

Arthad Kurlekar · Thursday, June 16th, 2016 · YIAG

Professor Pieter Sanders in 1999 famously asked "Quo Vadis Arbitration"? (Where do you go Arbitration?). In the Indian context this question is particularly relevant in light of the ever-fluctuating framework applicable to arbitrations seated in India. In this post, I will deal with one aspect of this inconsistency, namely the question of arbitrability. The Indian courts have struggled with the question of arbitrability, especially in crystallising an appropriate test to decide it. In 2011 the Indian Supreme Court made its first landmark attempt in *Booz Allen Hamilton v SBI Home Finance* (2011) 5 SCC 532.

Recently, the Bombay High Court has diverted from the test in Booz Allen. The particular struggle has been seen in two of its Judgments applying a uniform test, distinct from Booz Allen: *Rakesh Kumar Malhotra v Rajinder Kumar Malhotra* on 20 August 2014 (holding claims of oppression and mismanagement against a company as not arbitrable) and more recently on 12 April 2016 in *Eros International Media v Telemax Links* (where the court has held that IP disputes may be arbitrable subject to the relief sought).

The Booz Allen Hamilton Dictum

The case was a landmark in that it was the first and arguably the only decision expounding the concept of arbitrability. In this decision, the Indian Supreme Court gives a generic test and states:

"*Generally and traditionally all disputes relating to rights in personam are considered to be amenable to arbitration; and all disputes relating to rights in rem are required to be adjudicated by courts and public tribunals, being unsuited for private arbitration.*"

The Court clarifies that a right *in personam* is a right against a person, as opposed to a *right in rem* i.e. a right which attaches to a particular "thing" rather than a person, or creates a legal status such as citizenship, and which is therefore exercised against the world at large. Thus the test which it has sought to lay down is in the form of classification of rights as rights *in rem*, as those not arbitrable, and rights *in personam* as those which are arbitrable. It further states that a lis *in personam* associated with a lis *in rem* may also be arbitrable. Thus e.g. a breach of contract would be arbitrable, despite the existence of fraud present. *Prima facie*, this test seems to be clear in its ambit. The Court elaborates its idea by providing a non-exhaustive list of subject-matters incapable of settlement by arbitration such as constitutional disputes, divorce proceedings which would be declaratory of a status of a person, rights and liabilities relating to criminal offences, guardianship

etc.

It should be noted, however, that immediately succeeding this observation the court notes that "*[t]his is not […] a rigid or inflexible rule. Disputes relating to* ***sub-ordinate*** *rights in personam arising from rights in rem have always been considered to be arbitrable. (emphasis added)*". Thus although insolvency claims may not be arbitrable, the consequent breach in a contract by virtue of insolvency is arbitrable. To summarise, the test focuses on whether the action brought is in the nature of an action *in rem* or an action *in personam*. It focuses upon the question of whether a dispute is 'inherently' arbitrable due to the rights relied on in a dispute. Importantly (see below) it does not look into whether the individual **relief** sought in the action is *in rem* or *in personam*.

Emerging Trends

However, the Bombay High Court has differed in its interpretation. In 2014 in the *Rakesh Kumar Malhotra* case, it came up with a decision on the arbitrability of oppression and mismanagement (shareholders' claims against the company) under the Companies Act of India (1956). Such a dispute revolves around specific actions taken by the company defeating the shareholders' interest and, thus, applying the Booz-Allen test, this dispute would be arbitrable. In this case, however, the Bombay High Court held that the arbitrator could not grant the relief sought and hence the dispute was not arbitrable. The Court stated "[p]*arts of the reliefs may be in rem and … therefore, the nature of the reliefs sought and powers invoked necessarily exclude arbitrability*." As an illustration in that very case, the Court held that the relief sought was under Section 402 of the Companies Act 1956 which allowed the company law board (a specialised tribunal) exclusive power to regulate the affairs of a company. Such a power was not within the ordinary remedies available to a Civil Court and hence the dispute was incapable of settlement by arbitration. Unlike the Supreme Court in Booz Allen Hamilton, the Bombay High Court has sought to determine arbitrability based on the **relief** sought by the parties, and not by the nature of the legal rights being asserted.

Similarly, on 12 April 2016 the Bombay High Court gave a decision through which it found contractual rights relating to copyright to be arbitrable. In doing so, the High Court relied on the relief sought by the party namely, a remedy for breach of contract. Strictly applying the Booz Allen test, it would seem that the dispute was non-arbitrable, as the basis for the claim was a copyright (i.e. a right *in rem*).

To summarise, the focus of the High Court is primarily on the relief sought. As per both these decisions, if the relief sought by a party (as opposed to the right relied on by the party) is capable of settlement by arbitration the Court will refer the matter to arbitration.

Prima facie, the test based on the relief sought looks attractive, in that owing to the nature of relief, matters revolving around a contestation of rights in rem would be arbitrable. Arguably thus, a greater number of disputes would be arbitrable in comparison to the Booz Allen test. Even admitting the relative success of the relief test over the Booz Allen test, there are certain pragmatic problems with it.

Problems with the Arbitrability Tests

A major disadvantage of such an approach is that a party may be able to circumvent arbitration by praying for a relief technically outside the purview of the arbitrator. Such an apprehension has been anticipated in the *Rakesh Kumar Malhtora* case where the court states that the petition for relief

must not be "*mala fide, oppressive, vexatious and an attempt at 'dressing up' to evade an arbitration clause*". Thus any relief which ordinarily a civil court would not be empowered to grant but a specialised body (such as a Tribunal under the Companies Act 1956 of India) could, could frustrate the arbitration.

The burden of proving that the relief sought is vexatious becomes very high. At the outset, making the determination of whether such a relief could be granted in the present dispute, at the stage of enforcement of the arbitration clause (i.e. prior to pleading the merits) is a difficult prospect. In such a case in order to arbitrate a party would have to demonstrate that all the reliefs of the other party were prima facie arbitrable. This runs contrary to the view that if the parties have agreed to arbitrate, then maximum effect should be given to the agreement – a view upheld by the Indian Supreme Court in *Enercon v Enercon GmBH*. Thus for specific reliefs sought by a party, the burden of proof would vest with the person to show a dispute is arbitrable. Such a burden is untenable.

The Booz Allen test approach, which uses the right relied upon by the parties in the dispute, to classify it as arbitrable or not arbitrable, is untenable for two reasons: First, situations may occur such as in the case of *Eros International* where the relief is in essence arbitrable rendering the test of 'right relied on' inadequate. Second, the Booz-Allen test is too generic in its conception as it does not address issues such as whether lien over cargo, or rights in rem over moveable goods are arbitrable. As such the Supreme Court in the Booz Allen decision qualifies its test by saying that it cannot be a hard and fast rule.

Both tests, namely the one based on the remedy and the one based on the nature of the relief sought, remain ambiguous. Neither test clearly demarcates the boundaries of arbitrability. It leaves the determination open on a case by to case basis rendering arbitration in India more uncertain.

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