

Dispute Resolution Hotline

June 03, 2011

NO ARBITRATION FOR ENFORCEMENT OF MORTGAGE BY SALE.

INTRODUCTION:

The Supreme Court of India in the case of *Booze Allen and Hamilton Inc. ("Appellant")* –Vs- *SBI Home Finance Ltd. ("Respondent no.1")* & Ors.¹ held that enforcement of a mortgage by sale shall be tried by court and not by an arbitral tribunal. In this case the Supreme Court was examining the scope of Sec. 8 of the Arbitration & Conciliation Act, 1996.

FACTS OF THE CASE:

Capstone Investment Co. Pvt. Ltd. ("Respondent no.2") and Real Value Appliance Pvt. Ltd. ("Respondent no.3") were the owners of two flats in Mumbai. Respondent no.2 and Respondent no.3 had borrowed from Respondent no.1 under two loan agreements ("Loan Agreements") by securing the said two flats in favour of Respondent no.1.

The Appellant was permitted by Respondent no.2 and Respondent no.3 to use the two flats under two separate leave and license agreements ("Leave and License Agreements"). The Respondent no.1 was made confirming party to the said leave and license agreements.

A separate tri-partite deposit agreement ("Deposit Agreement") was entered among Respondent no.2 and Respondent no.3 as First Party, the Appellant as the Second Party and Respondent no.1 as the Third Party. Under the Deposit Agreement, the Appellant paid a refundable security deposit of Rs. 32, 500, 000 each totaling to Rs. 65, 000, 000 to Respondent no.2 and Respondent no.3.

The Loan Agreements, Leave and License Agreements and Deposit Agreement together formed a single integral transaction.

In terms of the Deposit Agreement, the Appellant paid a sum of Rs. 55, 000, 000 to the Respondent no.1 toward repayment of loan taken by Respondent no.2 and Respondent no.3. As a result of this repayment, the loan taken by Respondent no.2 with regard to one of the flats (Flat no. 9A) was repaid. Respondent no.2, became a guarantor for repayment of the amount due to the Respondent no.1 by Respondent no.3 and the said flat (Flat no. 9A) was secured in favour of Respondent no.1 by creating charge relating to shares of the said flat. Further, the Respondent no.1 confirmed that it had no objection to the Appellant, its employee or officer occupying the two flats and that as long as the balance of the principal amount and interest due thereon is paid by the Respondent no.2 and Respondent no.3 and as per separate arrangement recorded between Appellant and Respondent no.1, the Respondent no.1 shall not enforce the mortgage and will permit the Appellant, its employee or officer to occupy the said flats.

The other important clauses of the Deposit Agreement enabled the Appellant to continue to use and occupy the flats so long as the amounts paid by it as security deposit remained unpaid and also gave the option to the Appellant to pay the amounts due to the Respondent no.1 on behalf of the borrowers if any default is made by the Respondent no.2 and Respondent no.3 in paying any sum(s) due from time to time by them to the Respondent no.1 under the loan facility.

Clause 16 of the Deposit Agreement provided for arbitration and the said Clause is extracted as under:

"In case of any dispute with respect to creation and enforcement of charge over the said shares and the said Flats and realization of sales proceeds there from, application of sales proceeds towards discharge of liability of the Parties of the First Part to the parties of the Second Part and exercise of the right of the Party of the Second Part to continue to occupy the said Flats until entire dues as recorded in Clause 9 and 10 hereinabove are realized by the party of the Second Part, shall be referred to an Arbitrator who shall be retired Judge of Mumbai High Court and if no such Judge is ready and willing to enter upon the reference, any Senior Counsel practicing in Mumbai High Court shall be appointed as the Sole Arbitrator. The Arbitrator will be required to cite reasons for giving the award. The arbitration proceedings shall be governed by the Arbitration and Conciliation Ordinance 1996 or the enactment, re-enactment or amendment thereof. The arbitration proceedings shall be held at Mumbai."

During the currency of the license period, reference was made by Respondent no.3 to the Board of Industrial and Financial Reconstruction ("BIFR") under the Sick Industrial Companies (Special Provisions) Act, 1985 and in pursuance of it, one of the flats being Flat no. 9B was taken over by the official liquidator.

The Appellant in the meantime wrote to Respondent no.2 and Respondent no.3 that it was not interested in renewing the licenses on its expiry and asked for refund of the security deposit of Rs. 65, 000, 000. A copy of the said letter was endorsed to the BIFR and Respondent no.1. As there was no response to the said letter, the Appellant wrote a further letter to Respondent no.1 and Respondent no.2 stating that they would continue to occupy the flats if the security deposit was not refunded.

As the loan amount remained due and payable by Respondent no.3 to the Appellant, the Respondent No.1 filed a

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mortgage suit about two years later before the Bombay High Court against Respondent no.2, Respondent no.3 and the Appellant, in regard to the flat owned by Respondent no.2 (Flat no. 9A) being the mortgaged property. Respondent no.1 inter *alia sought* a declaration that Respondent no.2 as mortgagor owed monies to the Respondent no.1 and if the same is not paid by the date fixed by the Court for redemption, Respondent no. 1 had the right to redeem the amounts due from proceeds of sale of the suit property (Flat no. 9A and three garages). It also sought a direction against the Appellant for vacating the suit property.

BEFORE THE BOMBAY HIGH COURT

The Appellant contended that the Respondent no.1 had a contractual obligation towards the Appellant as it had agreed for Appellant's continued occupation of the said flats till the security deposit is refunded while the Respondent no.2 denied existence of any mortgage or charge over Flat no. 9A. An Application for temporary injunctions was taken out by the Respondent no.1 in which the Appellant filed a detailed reply.

Subsequently, the Appellant filed an application under Sec. 8 of Arbitration & Conciliation Act, 1996 (“**the Act**”)² praying that the parties to the suit be referred to arbitration in view of the arbitration clause contained in

Clause 16 of the Deposit Agreement. Respondent no.1 resisted this application. No written statement was filed by the Appellant.

The single judge of Bombay High Court rejected the Appellant's application on three grounds:

- (a) Clause 16 of the Deposit Agreement did not cover the dispute as the subject matter of the dispute was Respondent no.1's claim against its borrowers and therefore it was not open to Appellant to request the court to refer the parties to arbitration;
- (b) The counter-affidavit filed by Appellant to the Application filed for temporary injunction by the Respondent no.1 amounted to submission of the first statement on the substance of the dispute, before filing the application under section 8 of the Act and therefore Appellant lost the right to seek reference to arbitration; and
- (c) The application under section 8 of the Act was filed nearly two years after the institution of suit and after filing counter-affidavit to the Application for temporary injunction by the Respondent no.1, during which period Appellant had subjected itself to the jurisdiction of the High Court. In view of such inordinate delay, Appellant was not entitled to the relief under section 8 of the Act.

This order passed by the single judge of the Bombay High Court was challenged before the Supreme Court of India (“**impugned order**”).

BEFORE THE SUPREME COURT

While challenging the impugned order before the Supreme Court of India, the Appellant contended that parties to the suit were all parties to the Deposit Agreement containing the arbitration clause (Clause 16) and Respondent no.1's claim was for enforcement of the charge over Respondent no.2's flat and for realization of sale proceeds from it, which was specifically covered by Clause 16. The Appellant further contended that the dispute raised in the Suit instituted before the Bombay High Court was an arbitrable dispute and therefore the High Court should have referred the parties to arbitration under section 8 of the Act,

The Supreme Court framed four issues on which it decided the case:

1. Whether the subject matter of the suit fell within the scope of the arbitration agreement contained in clause 16 of the deposit agreement;
2. Whether the appellant had submitted his first statement on the substance of the dispute before filing the application under section 8 of the Act;
3. Whether the application under section 8 of the Act was liable to be rejected as it was filed nearly after two years from entering appearance in the suit; and
4. Whether the subject matter of the suit is 'arbitrable', that is capable of being adjudicated by a private forum (arbitral tribunal); and whether the High Court ought to have referred the parties to the suit to arbitration under section 8 of the Act.

On the first issue, the Supreme Court held that the subject matter of the suit fell within the scope of the arbitration agreement as (i) parties to the suit are parties to an agreement (Deposit Agreement) which contains the provision for settlement of disputes by arbitration and (ii) the Respondent no.1 instituted a suit before the Bombay High Court seeking to enforce the mortgage to recover amounts due to it and also sought for delivery of vacant possessions of the flats which were covered by Clause 16 of the Deposit Agreement.

With regard to the second issue, the Supreme Court was of the opinion that filing a detailed objection to an application for interim relief cannot be considered to be submission of a statement on the substance of the dispute resulting in submitting oneself to the jurisdiction of the court. Towards this the Supreme Court referred to *Rashtriya Ispat Nigam Ltd. –Vs- Verma Transport Company*.³ The Supreme Court also took into consideration the fact that the counter-affidavit filed by the Appellant to the Application brought out for temporary injunction by the Respondent no.1 was filed for the limited purpose of opposing the interim relief.

While deciding the third issue, the Supreme Court held that though Section 8 of the Act does not prescribe any time limit for filing an application, the scheme of the Act and the provisions of the section clearly indicate that the application should be made at the earliest. The Supreme Court stated that, “*Obviously, a party who willingly participates in the proceedings in the suit and subjects himself to the jurisdiction of the court cannot subsequently turn around and say that the parties should be referred arbitration in view of the existence of an arbitration agreement.*”

The Supreme Court further held that, “*If supplemental proceedings like application for temporary injunction on appointment of Receiver have been pending for a considerable time and a defendant has been contesting such supplemental proceedings, it cannot be said the defendant has lost the right to seek arbitration.*”

In the facts and circumstances of the case, the Supreme Court was of the view that since the plaintiff in the suit had

filed an application for temporary injunction and appointment of Receiver that was pending and since thereafter talks were in progress for arriving at a settlement out of court and the Appellant filed an application under section 8 of the Act only after failure of such settlement talks and before filing the written statement or any other statement which could be considered to be a submission of a statement on the substance of the dispute, therefore Bombay High Court was not justified in rejecting the application on the ground of delay.

ARBITRABILITY OF DISPUTES:

While deciding the final issue, the Supreme Court stated that the nature and scope of issues arising in an application under section 11 of Arbitration & Conciliation Act, 1996 ("**the Act**") for appointment of arbitrators is far narrower than of those arising in an application of section 8 of the Act in as much as in an application under section 11, the issue of 'arbitrability' is left for decision by the tribunal whereas the Court must decide the same in a section 8 application.

The Supreme Court was of the view that 'Arbitrability' covers three contexts - whether the disputes having regard to their nature are capable of being resolved by a private forum or fall exclusively within the domain of public fora; whether the disputes by agreement of parties are covered by the arbitration agreement and whether the disputes fall within the scope of submission to the arbitral tribunal, that is, whether parties have referred the dispute to arbitration.

Elaborating on the first category of 'arbitrability' the Supreme Court first went on to state that certain categories of proceedings were reserved for public fora for public policy reasons either expressly or by necessary implication and hence not arbitrable. The Supreme Court has clearly stated that where the cause/dispute is not arbitrable, the court where a suit is pending will refuse to refer the parties to arbitration under Sec.8 of the Act even if parties might have agreed as the forum for settlement of such disputes.

Examples given by the Supreme Court of non-arbitrable disputes are: (i) disputes relating to rights and liabilities which give rise to or arise out of criminal offences; (ii) matrimonial disputes relating to divorce, judicial separation, restitution of conjugal rights, child custody; (iii) guardianship matters; (iv) insolvency and winding up matters; (v) testamentary matters (grant of probate, letters of administration and succession certificate); and (vi) eviction or tenancy matters governed by special statutes where the tenant enjoys statutory protection against eviction and only the specified courts are conferred jurisdiction to grant eviction or decide the disputes. The Supreme Court elaborated that all of the above examples are rights *in rem*, exercisable against the world at large, as opposed to rights *in personam*- interests protected against specific individuals. The Supreme Court stated that though the Act does not exclude any category of disputes as not arbitrable, the only indication regarding arbitrability in the Act are sections 34(2)(b) and 48(2) of the Act which provide that an arbitral award would be set aside if the court found that "*the subject matter of the dispute is not capable of settlement by arbitration under the law for the time being in force.*"

SUIT FOR ENFORCEMENT MORTGAGE NOT ARBITRABLE:

The Supreme Court held that, "*An agreement to sell or an agreement to mortgage does not involve transfer of any transfer of right in rem but create only a personal obligation. Therefore if specific performance is sought in regard to an agreement to sell or an agreement to mortgage, the claim for specific performance will be arbitrable. On the other hand, a mortgage is a transfer of a right in rem. A mortgage suit for sale of the mortgaged property is an action in rem, for enforcement of a right in rem. A suit on mortgage is not a mere money suit. A suit for enforcement of a mortgage being the enforcement of a right in rem, will have to be decided by courts of law and not by arbitral tribunals.*"

One of the contentions raised by the Appellant was that the core issues in the suit being (i) Whether there is a valid mortgage or charge in favour of Respondent no.1; (ii) What is the amount due to Appellant and (iii) Whether Respondent no.1 could seek Appellant's eviction could be decided by a private forum. However, the

Supreme Court was of the opinion that although the issues referred to by the Appellant could separately be submitted to arbitration, however the issues in a mortgage suit cannot be divided as, "*a mortgage suit is not only about determination of the existence of the mortgage or determination of the amount due. It is about enforcement of the mortgage with reference to an immovable property and adjudicating upon the rights and obligations of several classes of persons... , who have the right to participate in the proceedings relating to the enforcement of the mortgage vis-à-vis the mortgagor or mortgage.*"

In this regard, Supreme Court also relied on *Sukanya Holdings v. Jayesh Pandya*⁴ which held that bifurcation of a suit and partly referring a dispute to arbitration is not permissible in the scheme of the Act.

In light of the above, the impugned order was upheld by the Supreme Court though adopting different reasoning.

ANALYSIS:

In this landmark judgment, the Supreme Court of India laid down the scope of examination in an application under Section 8 of the Act in as much as the Court must decide the issue of 'arbitrability' while deciding section 8 application. The Supreme Court clearly indicated the grounds on which a dispute would be held as non-arbitrable and most importantly the Supreme Court of India created a new class of suits being suits for enforcement of mortgage by sale as a carve out from the disputes which are arbitrable.

- Debargha Basu, Vyapak Desai & Vivek Kathpalia

¹ Civil Appeal No. 5440 of 2002

² Sec. 8 of Arbitration & Conciliation Act, 1996 reads:

" 8. Power to refer parties to arbitration where there is an arbitration agreement.

(1) A judicial authority before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party so applies not later than when submitting his first statement on the substance of the dispute, refer the parties to arbitration.

(2) The application referred to in subsection (1) shall not be entertained unless it is accompanied by the original arbitration agreement or a duly certified copy thereof.

(3) Notwithstanding that an application has been made under sub- section (1) and that the issue is pending before

the judicial authority, an arbitration may be commenced or continued and an arbitral award made. “

3 2006 (7) SCC 275

4 (2003) 5 SCC 531

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