

# Dispute Resolution Hotline

August 23, 2016

## IN CIVIL COURTS WE 'TRUST': TRUST DISPUTES INARBITRABLE IN INDIA

- Disputes arising out of Trust Deeds and the Indian Trusts Act, 1882 cannot be referred to arbitration.
- Clauses providing for arbitration in a Trust Deed do not constitute an "arbitration agreement".
- Provisions governing dispute resolution and legal remedies in the Trusts Act act as an implied bar to arbitration of trust related disputes.

### INTRODUCTION

The Supreme Court of India ("**SC**"), in *Vimal Shah & Ors. vs Jayesh Shah & Ors.*<sup>1</sup>, recently held that disputes arising between beneficiaries or trustees of a Trust cannot be referred to arbitration as an arbitration clause contained in a Trust Deed is not an "arbitration agreement" between the trustees inter se, between the beneficiaries inter se or between the trustees and the beneficiaries for the purposes of the Arbitration & Conciliation Act, 1996 ("**Arbitration Act**") unless the respective parties specifically agree to the same.

It was further held that all disputes arising out of a Trust Deed and the Indian Trusts Act, 1882 ("**Trust Act**") are not arbitrable in India.

This ruling is significant because, currently, several trust deeds of private trusts governed by the Trust Act contain arbitration clauses in relation to resolution of disputes between trustees, between beneficiaries and between trustees and beneficiaries. Due to the high likelihood of potential disputes when relationship between family members get strained, especially in cases where the trustee is given discretionary powers on various aspects (including distributions to beneficiaries, investment decisions, etc.), such arbitration provisions have been considered highly important, given key advantages such as timely resolution of disputes, confidentiality, efficiency and the flexibility to appoint arbitrators who have knowledge about the affairs of the family, etc. Moreover, in the past few years appointment of institutional trustees have been on the rise on account of their ability to act independently and professionally. When institutional trustees are so appointed, arbitration clauses give such institutional trustees a lot of comfort in terms of taking up the role of a trustee, particularly, as trustees are bound by fiduciary obligations, which are subjective in nature.

### BACKGROUND

A Trust is a legal obligation annexed to the ownership of property and is not a separate legal entity. A Trust arises out of confidence placed by a person (referred to as the settlor) in another (the trustee), for the benefit of certain persons (the beneficiaries) as identified by the settlor. The trustee is the legal and beneficial owner of the trust property. A Trust Deed is an instrument by which the settlor reposes confidence in a trustee and settles property into the Trust. Typically, a trust deed is only executed by the settlor and the trustees.

In the present case, a family trust deed ("**Trust Deed**") had been executed in favor of six minor beneficiaries. Clause 20 of the Trust Deed contained an arbitration clause, providing that

*"any dispute or differences dispute or difference arising regarding the interpretation of the Trust Deed or any disputes arising inter se trustees, between the trustees and beneficiaries or inter se beneficiaries shall be resolved under the Indian Arbitration Act, 1940 and the decision of the arbitrator(s) shall be final and shall bind the parties to the arbitration."*

Differences arose among the beneficiaries with respect to the conduct of the affairs and business of the trust. An application under Section 11 of the Arbitration Act was made by some of the beneficiaries to refer the disputes to arbitration in accordance with Clause 20 of the Trust Deed. The Bombay High Court allowed the application referring the disputes to arbitration. Aggrieved by such order, other beneficiaries filed an appeal before the SC by way of special leave.

### ISSUES

The following issues were before the SC for determination in the present appeal:

1. Was an arbitration clause contained in a Trust Deed a valid arbitration agreement for resolution of disputes between beneficiaries of a Trust?
2. Whether trust-related disputes are arbitrable in India?

### JUDGMENT

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## 1. Is an arbitration clause in a Trust Deed a valid “arbitration agreement” under the Act?

The SC found that an arbitration clause contained in a Trust Deed does not meet the requirements of a valid arbitration agreement prescribed in the Arbitration Act.

The SC relied on its earlier judgment in *Vijay Kumar Sharma*<sup>2</sup> which held that an arbitration clause contained in a Will is not a valid arbitration agreement since the legatees are not signatories to the testamentary document. Comparing Trust Deeds with testamentary documents, the SC held that beneficiaries of a trust, like legatees to a Will, are not parties to an arbitration agreement since they do not execute the trust deed containing the arbitration clause. Furthermore, the SC clarified that even if the beneficiaries are considered to have accepted the trust deed vis-a-vis the settlor by accepting the benefits thereunder, such acceptance does not imply that an arbitration agreement exists for the resolution of disputes between beneficiaries, trustees, or between trustees and beneficiaries.

The SC further referred to the Calcutta High Court ruling in *Bijoy Ballav Kundu*<sup>3</sup> which held that upon signing a Trust Deed, trustees only undertake to carry out the terms of the Trust Deed in accordance with applicable law. Further, it was held that interpreting arbitration clause in a trust deed as an arbitration agreement *inter se* the trustees would be absurd as the arbitration clause does not satisfy a basic requirement for constituting an agreement *inter-se* the trustees, i.e., there is no proposal and acceptance between them.

The SC held that similar to the above, merely by virtue of Beneficiaries accepting a trust deed by accepting benefits under the Trust, the trust deed cannot be interpreted as an agreement *inter se* the beneficiaries and the present dispute could not be referred to arbitration for want of a valid arbitration agreement.

## 2. Are trust disputes arbitrable in India?

Arbitration is a private dispute resolution mechanism available to resolve civil and commercial disputes. However, certain varieties of disputes are considered inarbitrable in the interest of public policy and can only be addressed in a competent public forum. In an earlier judgment of *Booz Allen & Hamilton Inc. vs SBI Home Finance Ltd*<sup>4</sup>, the Supreme Court of India has listed six varieties of disputes as inarbitrable in India. They are: (i) rights and liabilities arising out of or giving rise to criminal offences; (ii) matrimonial disputes; (iii) guardianship matters; (iv) insolvency and winding up; (v) testamentary matters; (vi) eviction or tenancy matters where tenants enjoy statutory protection. In the present case, the SC laid down an additional category of cases to the list of disputes considered to be inarbitrable in India i.e. disputes arising out of a Trust Deed or otherwise covered by the Trusts Act.

The SC analyzed the scheme of the Trust Act finding that it comprehensively and adequately covers each subject pertaining to trust law, right from the creation of the trust and extending to management of the trust as well as provisions relating to beneficiaries and trustees, including remedies available to get grievances settled. Specifically on the point of legal remedies, the SC observed that the Trust Act provides specifically for the resolution of various disputes and confers jurisdiction for the same on Civil Courts. The SC referred to the principle of interpretation that where a specific remedy is prescribed by statute, the person facing such a grievance is denied of any other remedy. Therefore, the SC concluded that the presence of provisions in the Trust Act specifically dealing with the forum for dispute resolution reflects the intention of the legislature to impliedly bar arbitration of such disputes.

## ANALYSIS

Trusts may be public (i.e., charitable or religious) or private. Public trusts are governed by specific state legislations on charitable and religious trusts and are not particularly governed by the Trust Act, even though general common law principles underlying the Trust Act are also applicable to public trusts. It may be against the public policy of a country to allow arbitration of disputes arising in public trusts. However, extending that principle to private trusts, including commercial trusts, may not be in the best interest of the stakeholders involved. In terms of value of assets held in trust, the vast majority are trusts of a commercial nature, including but not limited to pension schemes and investment funds.

Disputes listed as inarbitrable in India in the earlier ruling of *Booz Allen* have been found to be better resolved in public fora as a matter of public policy. However, given the benefits of arbitration which are well-known and manifold, various disputes arising out of Trust Deeds are better suited to arbitration, such as disputes involving: (a) fees and costs, including trustee's fees and legal fees; (b) appropriateness of investments; (c) interpretation of trust deed; (d) protection of trust corpus and income; (e) trust termination & severances; (f) trust accounting; (f) appointment, removal and retirement of trustees; etc.

The finding that disputes arising out of Trust Deeds and in relation to the Trust Act are inarbitrable is a departure from the previous position taken by the Delhi High Court in *Chhaya Shriram*.<sup>5</sup> In that case, the court had held that beneficiary has benefits in the trust not by virtue of a contract with the Trustee(s) and/or Settlor and that therefore, an arbitration clause in a Trust Deed is not a valid agreement to arbitrate for disputes between beneficiaries. To that extent, the SC does not deviate from the HC's ruling. However, the court did not consider trust-related disputes to be inarbitrable, *per se*, and it recognized that a separate arbitration agreement between beneficiaries could constitute a valid arbitration agreement. The present SC judgment was in appeal to a judgment of the Bombay High Court which had found that the beneficiary is in a contractual relationship with the Trustee and a Settlor. The present judgment confirms that the nature of the relationship is not contractual on the same lines as what was held by the Delhi HC. However, it remains to be clarified if the beneficiaries among themselves can create a contractual relationship with regards to the distribution of benefits of the trust.

Having said that, in the context of the recent ruling and in the context of the importance of arbitration options for private trusts, for trust disputes to be arbitrable in India, a statutory amendment to the Trusts Act appears to be necessary in line with those found in various other jurisdictions.<sup>6</sup> In the interim, parties can seek mediation and binding conciliation of disputes as an alternative to the remedies available under the Trusts Act.

<sup>1</sup> Civil Appeal No. 8164 of 2016

<sup>2</sup> 2010 (2) SCC 486

<sup>3</sup> AIR 1965 Calcutta 628

<sup>4</sup> (2011) 5 SCC 532

<sup>5</sup> AAP 61 of 2008, dated 19 February 2008.

<sup>6</sup> For example, section 63 of the **Trusts (Guernsey) Law 2007** provides that,

**Settlement of action against trustee by alternative dispute resolution to be binding on beneficiaries.**

**63.** (1) Where –

(a) the terms of a trust direct or authorise, or the Court so orders, that any claim against a trustee founded on breach of trust may be referred to alternative dispute resolution ("**ADR**"),

(b) such a claim arises and, in accordance with the terms of the trust or the Court's order, is referred to ADR, and

(c) the ADR results in a settlement of the claim which is recorded in a document signed by or on behalf of all parties,

the settlement is binding on all beneficiaries of the trust, whether or not yet ascertained or in existence, and whether or not minors or persons under legal disability.

(2) Subsection (1) applies in respect of a beneficiary only if –

(a) he was represented in the ADR proceedings (whether personally, or by his guardian, or as the member of a class, or otherwise), or

(b) if not so represented, he had notice of the ADR proceedings and a reasonable opportunity of being heard, and only if, in the case of a beneficiary who is not yet ascertained or in existence, or who is a minor or person under legal disability, the person conducting the ADR proceedings certifies that he was independently represented by a person appointed for the purpose by a court of law.

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