ARBITRABILITY OF FRAUD - JUDICIARY'S CONTEMPORARY STANCE

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ABSTRACT

Arbitrability of fraud is a legal issue that has been a victim to lack of clarity in legislations, vague worded judgements and diverging stances taken by various courts. Earlier, the courts did not trust arbitration's capabilities to handle such a dispute but the more recent judgements have discarded that view and taken a more pro-arbitration stance. The pro arbitration stance can be seen in the 2020 judgement of Avitel which settled the jurisprudence on this matter by laying down two tests to decide which disputes are arbitrable and which are not. While most of the literature has seen Avitel as the concluding chapter in the book of arbitrability of fraud, this paper will analyse the judgements and legislations that followed Avitel and examine the current stance taken by the judiciary. This paper will endeavour to discuss the evolution of case law on arbitrability of fraud, highlight the impact of the 2020 ordinance and elaborate on the contemporary stance taken by the courts.

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1. INTRODUCTION

Fraud can be defined as deceiving another person by lying to him or withholding necessary information with the intent of inducing him to enter into a particular contract.[1] Shifting focus to arbitrability, it is concerned with whether a type of a dispute can or cannot be settled by arbitration. When a dispute is held to be non-arbitrable, it falls within the jurisdiction of the courts. Further, as per Article 36(1)(*b*) of the UNCITRAL Model Law, a court can refuse enforcement if it finds that the subject-matter of the dispute is not capable of settlement under the law of the State.[2] Surprisingly, there is no clear definition of arbitrability in Indian legislations including the Arbitration and Conciliation Act, 1996 and the 2015 amendment to it. This confusion is only heightened when the issue of fraud is combined with it as no Indian legislation gives a clear answer to the issue of arbitrability of fraud.

However, the courts resort to other sections while deciding matters of arbitrability. Section 8 states that the courts have the power to refer the cases to arbitration if a valid arbitration agreement exists. Further, Section 34(2)(b) ensures that awards can be set aside if the subject matter is not arbitrable. Since, these section are not conclusive, the judiciary has taken differing stances on this topic. Despite two major legislations, at least 8 landmark decisions, and recommendations made by the Indian Law Commission, no legislative clarity existed until quite recently.[3]

2. EARLIER STANCE OF THE JUDICIARY

The case of *Russel v. Russel*[4] in 1880 was the first prominent case on the question of arbitrability of fraud. This case laid down the principle that if *prima facie* evidence supports the occurrence of fraud, then the court has the power to intervene and prohibit the matter from being referred for arbitration.[5]

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[1] Section 17 of the Contract Act, 1872

[2] Shuchi Sejwar and Arpit Lahoti, 'Arbitrability Of Fraud: Is The Anomaly Solved | SCC Blog' (*SCC Blog*, 2021) <https://www.google.com/amp/s/www.scconline.com/post/2021/02/27/arbitrability-of-fraud/%3famp> accessed 10 September 2021.

[3] Sarah Mir, 'The Tests For Determining Arbitrability Of Fraud In India: Clearing The Mist - Kluwer Arbitration Blog' (*Kluwer Arbitration Blog*, 2020) <http://arbitrationblog.kluwerarbitration.com/2020/10/06/the-tests-for-determining-arbitrability-of-fraud-in-india-clearing-the-mist/> accessed 10 September 2021.

[4] (1880) LR 14 Ch D 471

[5] Supra Note 3.

This case was followed by *Abdul Kadir Shamsuddin Bubere* v. *Madhav Prabhakar Oak*[6] in the year 1962. The Indian Supreme Court made two important observations.[7] *Firstly*, not every case which includes an allegation of fraud would lead to the arbitration proceedings being dissolved. The court will intervene only when the allegation of fraud was serious in nature. *Secondly*, the court said that the desire of the parties will be taken into consideration and seen as sufficient cause on whether the matter should go to arbitration or court. The matter will go to court when there are 'serious allegations of fraud' against a party and the said party is of the desire that the matter be tried in open court. The reasoning behind this is that the party who is charged with fraud should decide whether his character judgement should take place in a public or private forum. Thus, this decision followed Russel v Russel but also added some additional conditions. A limitation of this case is that it does not address what would happen if there is a serious allegation of fraud but the accused wishes to go to arbitration.

The next major case that discusses arbitrability of fraud is *N. Radhakrishnan v. Maestro Engineers*[8]. It held that when a suit involves serious allegations of fraud, the matter is not arbitrable because given the evidence-heavy nature of investigation courts will be more suited to solve the dispute. It is pertinent to note that even though this judgement followed the precedent set by the previous two cases, it was in violation of section 8 of the 1996 Act, which was extremely different from section 20(4) of the Arbitration and Conciliation Act, 1940 that was in place when the Supreme Court decided *Abdul Kadir*.[9]

This judgement was problematic for three main reasons. *Firstly*, it was in violation of section 8. Section 8 clearly states that if an arbitration clause exists in an arbitration agreement and that agreement is produced before the court, the court has to send the matter to arbitration. The mandatory language of Section 8 implies that under no circumstances, including cases with serious allegations of fraud, can the court refuse to refer the matter to arbitration if the agreement exists.[10]

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[6] (1962) AIR 406

[7] 'Does Fraud Vitiate Arbitration? Revisiting Arbitrability Of Frauds In India - Rgnul Student Research Review (RSRR)' (*RGNUL Student Research Review (RSRR)*, 2021) <http://rsrr.in/2021/02/07/arbitrability-fraud-india/> accessed 10 September 2021.

[8] (2009) (13) SCALE 403

[9] 'Analysing India's Problematic Jurisprudence' - Indian Journal of Arbitration Law Arbitrability of Fraud: 8 IJAL (2020) 141

[10] Ibid.

Secondly, it neither followed nor distinguished the Supreme Court judgement of *Hindustan Petroleum Corporation Ltd. v. Pinkcity Midway Petroleums*[11] which laid down the precedent that "if in an agreement between the parties before the civil court, there is a clause for arbitration, it is mandatory for the civil court to refer the dispute to an arbitrator."[12]

Thirdly, it displayed the lack of trust the judiciary had on the arbitration machinery. This is because the court said that courts are more competent to try matters concerning serious allegations of fraud as they have the required means to decide such a complicated matter.[13]

3. EVOLUTION OF THE JURISPRUDENCE

The following year in July 2010, the case of *Jamuna Transport Corporation v. Ghanshyamdas Baheti & Ors.*[14] was decided which was the first case to increase the threshold for courts' interference so that not every frivolous suit claiming fraud would result in the dissolution of arbitration proceedings. It laid down the principle that not every allegation questioning the physical existence of an arbitration agreement due to fraud would be admitted in court. The mere filing of a suit challenging the existence of an arbitration agreement due to fraudulent activities will not preclude the arbitral tribunal from carrying out the due procedure. It is only in cases where there is enough evidence of a seriously credible charge of fraud that makes the court question the validity of the arbitration agreement, would arbitration proceedings be set aside. This was done to avoid opening up the floodgates resulting in every knave to concoct a fraud claim just to postpone the arbitration proceedings.

Building on the previous precedents, a couple months later in September 2010, *Bombay High Court Building v/s St. Denis Street*[15] was decided by Bombay High Court. This case followed *N. Radhakrishnan v. Maestro Engineers* in holding that when there are serious allegations of fraud, requiring detailed examination of witnesses, it is not suitable to be decided using arbitration and have to be decided by courts. As stated above, this is a problematic view as it reflects the lack of faith judiciary has on the justice delivered during arbitration proceedings.

Furthermore, it also built on the *Abdul Kadir* case on the point that the choice of the parties should be taken into consideration when deciding the means of dispute resolution. This case

[11] (2003) 6 SCC 503

[12] Ibid

[13] Supra note 7

[14] (2010) (4) CHN (Cal) 488

[15]

held that the choice of the parties will be given due regard except when vital issues of fraud and public policy are raised, and when interests of third parties are involved. When these additional issues are added to the dispute, the court will independently decide whether the matter will go to a domestic tribunal in confidentiality or whether it will be decided by a court.

The next case is the decision of the Supreme Court in *Swiss Timing Ltd. v/s Commonwealth Games Organising Committee*[16]. Its first important aspect is that it criticised the decision in the Radhakrishnan case for the same reasons as stated above. Secondly, it stated that a dispute where fraud is alleged will only go to court if the arbitration agreement is vitiated. However, the judge also gave a caveat and said that the defence of the contract being void is now-a-days taken routinely with the motive to avoid/delay reference to arbitration and such ground needs to be summarily rejected unless there is clear indication that the defence has a reasonable chance of success.

Thirdly, the timing of alleging fraud is also of essence. If the allegation of fraud is never made before during the arbitration proceedings and is brought up for the very first time when the plea is taken in court, then the matter is more appropriate to be heard by the Arbitral Tribunal.

Fourthly, court *"also held that the lodging of a criminal case would not bar reference to an arbitration tribunal."*[17] However this judgement was not given the stature of binding precedent as it was delivered by single judge and Radhakrishnan was delivered by a division bench.

World Sport Group (Mauritius) Ltd. v. MSM satellite Pte Ltd,[18] went one step ahead of the previous case and held that unless the arbitration agreement is held to be *null and void*, or inoperative in nature, the allegations concerning fraud can be decided by the arbitral tribunal itself. In doing so, it specifically declined to accept the judgements in *Abdul Kadir Shamsuddin Bubere* v. *Madhav Prabhakar Oak* and *N. Radhakrishnan v. Maestro Engineers, 2009* which had rejected references to arbitration when there were serious issues of fraud involved. The court reasoned that the current matter concerns foreign arbitration while

[16] Supreme Court of India, Arbitration Petition No 34 of 2013

[17] Supra note 7

[18] (2014) 11 SCC 639

"*Abdul Kadir* and *N Radhakrishnan* were domestic arbitration cases. So, in deciding this dispute under Section 45 of the Act, it shall not rely upon domestic disputes." [19]

In the same year, the Law Commission's 246th Report was published which proposed an addition of S.16(6) which would give the arbitral tribunal power to pass an award even in matters consisting of allegations of fraud. This section would not disallow the parties from raising the issue of arbitrability before the arbitrator at the pre-award stage. Even if their arbitrability claim is denied, there would be an option of challenging the award in court even at the post-award stage, on the ground of conflicting with the public policy of India under Section 34(2)(b)(ii) of the 1996 Act.[20]

However, Indian Parliament decided not to incorporate the recommendation of the Law Commission. Later, the court interpreted this decision as the parliament leaving it to the courts to work out the fraud exception on a case-by-case basis. However, this is problematic "as it will lead to a "a case by case" determination of what constitutes fraud and will result in unnecessary judicial intervention and delay. This approach would harm the existing regime of arbitration to a considerable extent."[21]

Punjab National Bank vs Kohinoor Foods Limited[22], decided on 13 February 2015, added a layer of complexity to the jurisprudence on the wish of the parties which was established in the case of *Abdul Kadir*. It held that in addition to considering the wish of the parties, it is pertinent to consider the wish of a specific party – the accused. The judge said that "*Though I quite agree it is within the discretion of the Court to say, where one of the two partners desires it, that a dispute shall not be referred to arbitration, yet I must consider for a moment which of the two partners does desire to exclude arbitration. Does the party charging the fraud desire it, or the party charged with the fraud desire it?"* The court would not hold the desire of the person charging the fraud to be sufficient reason for the Court refusing to send the case to arbitration.

However, the accused's desire be tried by a public fora such as a court would be see as sufficient reason. Reason behind this is that the person alleging the fraud does not have his reputation at stake and could want a court trial to harm the accused's reputation. The accused

[19] Supra note 7

[20] Supra note 3

[21] Supra note 4

[22] Punjab High Court, Arb. Petition No. 534 of 2013

is the one whose reputation could be irreversible damaged by the court trial and the public glare associated with it and thus, his wish should be given priority.

Even after clarifying the courts' stance on whose desire would be considered sufficient ground, the court did not give it due regard. They instead held that since the allegations of fraud were of a serious nature, they ought to be determined by a civil court. This was done despite the fact that the person who had been charged with fraud sought to trigger the arbitration mechanism, the court did not oblige.

This case followed the Denis case but it made an additional clarification that the criteria of seriousness of the fraud alleged is given more importance than the criteria of whether the accused person wishes to be tried in court of in arbitration.

The 2016 case of *A. Ayyasamy v. A. Paramasivam and Ors*[23] held that once there was an arbitration agreement amongst the parties, the court had no discretion to deviate from compelling the parties to proceed for arbitration. This judgement upheld the precedent established by *Petroleum Corporation Ltd. v. Pinkcity Midway Petroleums* which was previously ignored in Radhakrishnan case. Additionally, it held that court would be allowed to intervene when the dispute involved internal matters of parties and affected public domain or when validity of Arbitration Agreement was questioned till such an extent that the root of the agreement or the validity of clause was being deliberated upon. These criteria made up allegation of 'serious fraud'. And when these elements were not at play, then the case was capable of being resolved through Arbitration.

In 2018, *Ameet Lalchand Shah vs Rishabh Enterprises*[24] applied the Ayyasamy judgement. It stated that only when serious questions of fraud are involved, the arbitration can be refused and they decided what a serious allegation was based on the definition given in Ayyasamy.

This case was followed by *Rashid Raza v. Sadaf Akhtar, 2019*[25]. It followed the previous two precedents and went one step further by laying down the two prolonged test to determine if an allegation was serious/complex enough to merit the court's intervention. The two-part test is that the arbitration agreement should be vitiated and the dispute should involve internal matters of parties and affect public domain. The legal backing of this judgement could have been found in the then existent Section 11(6A) of the 1996 Act, which was later removed.

[23] (2016) 10 SCC 386

[24] (2018) 15 SCC 678

[25] (2019) 8 SCC 710

The section restricted the scope of courts in declining references to arbitration and the role of courts were limited to examining whether a valid arbitration agreement existed. [26]

4. OUTLOOK ADOPTED IN 2020 AND 2021- HIGHER STANDARD FOR NON-ARBITRABILITY

The *Avitel Post Studioz Limited and Ors. v. HSBC PI Holdings (Mauritius) Limited and Ors.*[27] case held that when mere allegations of fraud simpliciter exists, the Hon'ble Supreme Court must not nullify the arbitration agreement as the arbitral tribunal could determine such issues. "The following two tests were emphasised by the Apex Court to determine what constitutes "serious allegation of fraud": 1. Whether the plea permeates the entire contract and above all, the agreement of arbitration, rendering it void?; or alternatively 2. Whether the allegations of fraud touch upon the parties' internal affairs inter se having no implication in the public domain?" [28]

Along with judicial pronouncements, there was significant development in the legislative domain on the theme of arbitrability of fraud. On 4th November 2020, Government of India passed the Arbitration and Conciliation (Amendment) Ordinance 2020. "The Ordinance introduces provisions to stay the enforcement of arbitral awards tainted by fraud, and deletes certain provisions from the Act relating to qualification and accreditation of arbitrators."[29] A proviso to section 36 was added which stated that if there is prima facie evidence of the fact that that the arbitration agreement or the making of the award was tainted with fraud or corruption, the court has the power to stay the award unconditionally pending disposal of the challenge under section 34 to the award. Here, the importance of prima facie evidence can be clearly seen. [30]

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[26] Supra note 7

[27] (2014) SCC OnLine Bom 929

[28] Vasanth Rajasekaran, 'The Evolving Jurisprudence Of 'Arbitrability Of Fraud' In India – Where Do We Stand? - Litigation, Mediation & Arbitration - India' (*Mondaq.com*, 2021) <https://www.mondaq.com/india/arbitration-dispute-resolution/1039916/the-evolving-jurisprudence-of-39arbitrability-of-fraud39-in-india-where-do-we-stand> accessed 10 September 2021.

[29] Nicholas Peacock and Nihal Joseph, 'Recent Developments In India-Related Arbitration' (*Lexology*) <https://www.lexology.com/library/detail.aspx?g=3de52544-7051-4d33-90e5-9b6b3f125cbc> accessed 10 September 2021.

[30] Nubee Naved and Samaksh Goyal, 'Fraud And Its Effect On Arbitral Awards In India: Have The Legal Developments Of 2020 Given Us A Clear Path?' (*Bar and Bench - Indian Legal news*, 2020) <https://www.barandbench.com/columns/fraud-effect-arbitral-awards-india-legal-developments-2020> accessed 10 September 2021.

This ordinance has a retrospective application as well. The explanation to the proviso stated that the amendment shall apply to all cases irrespective of whether court or arbitral proceedings had commenced before or after the Arbitration and Conciliation Act, 2015.

In December of 2020, the Supreme Court dealt with the case of *Vidya Drolia vs Durga Trading Corporation*[31]*, 2020.* The court took a clear stand on arbitrability of fraud. It stated that non-arbitrability depends on whether: (a) the dispute affects rights *in rem*, (b) it affects the rights of third parties, or requires central adjudication, (c) the subject matter has any relation to sovereign or public interest functions of the State, or (d) the mandatory law has expressly or implied barred any reference to arbitration.[32]

The first condition relating to rights in rem is in accordance with the 2011 case of *Booz Allen and Hamilton Inc. v. SBI Home Finance Ltd* which held that the disputes dealing with rights in personam were arbitrable whereas the rights in rem were not arbitrable as they have the potential to affect the society at large. [33]

These conditions are in addition to the main test of whether the arbitration clause has been vitiated. To determine the prima facie validity of the arbitration agreement, the court has to delve into questions of whether the examine the prima facie validity of an arbitration agreement includes only: a. Whether the arbitration agreement was in writing, whether the arbitration agreement was contained in exchange of letters, telecommunication, and whether the core contractual ingredients qua the arbitration agreement were fulfilled. If these questions result in an affirmative answer, the matter would go to arbitration, negative answer would send the matter to court and if the validity of the arbitration agreement could not be determined on a prima facie basis, the matter would again go to arbitration.

This judgement clarifies the matter of arbitrability of fraud and puts it into simple words. This is the most comprehensive judgement as it takes into account previous decisions and forms the perfect end to the evolution of the jurisprudent on arbitrability of fraud.

Shifting focus to the cases in 2021 regarding arbitrability of fraud, the next case is *M/S N.N. Global Mercantile Pvt. Ltd. vs M/S Indo Unique Flame Ltd., 11 January 2021*[34]. Supreme

[31] (2021) 2 SCC 1

[32] Sumit Chatterjee and Rajashri Seal, 'Vidya Drolia Case: Final Chapter In The Arbitrability Of Fraud Saga? - Indiacorplaw' (*Indiacorplaw.in*, 2021) <https://indiacorplaw.in/2021/01/vidya-drolia-case-final-chapter-in-the-arbitrability-of-fraud-saga.html/amp> accessed 10 September 2021.

[33] Supra note 3

[34] (2021) SCC OnLine SC 13

Court once again reinforced the position in contemporary arbitration jurisprudence that fraud is arbitrable. The only exception is when the fraud goes to the root of the arbitration agreement and renders the arbitration clause void. The exception aspect of this judgment was that it clarified that criminal aspect of fraud that result in penal consequences and sanctions can only be adjudicated by a court of law since it may result in a conviction which falls in the realm of public law.

The second major case of 2021 is *M/S Bihar Home Developers And Builders vs Shri Narendra Prasad Gupta*, 7 July 2021. The Patna High Court relied on previous cases of Ayyasamy, Avitel, Vidya and Global Mercantile and held that the civil aspect of fraud is arbitrable but the arbitration clause being vitiated would serve as an exception to the contemporary view on arbitrability.[35]

The final case this paper will discuss is *Weiss Technik India Private Limited vs Ms. Bollupalli Madhavilatha* which was heard by the Telangana High Court. It was held that fraud would not be considered non-arbitrable when there was "voluminous and extensive evidence and would be too complicated to be decided in arbitration,"[36] was held to be an archaic view which has become obsolete and deserves to be discarded. This is because the ground reality is that arbitral tribunals are required to traverse through volumes of material on a daily basis when dealing with cases involving in various kinds of disputes in oil, natural gas, or construction industry. This case went against the 2009 case of Radhakrishnan which held that serious allegations of fraud should not be arbitrable given the evidence-heavy nature of investigation, the courts will be more suited to solve the dispute. The Radhakrishnan case displayed the lack of trust the judiciary had on arbitration mechanism and the present case, reinstated that trust, and gave it the due respect in deserved. This is an excellent example of how the jurisprudence has evolved in the past decade.

5. CONCLUSION

Indian jurisprudence has evolved along the same lines as that of Singapore, an arbitration friendly jurisdiction. However, Indian courts can take a cue from Singapore courts as well in matters of nature of evidence. The Singapore High Court[37] ruled that an allegation of fraud made wit respect to arbitration proceedings must be supported by compelling evidence which

[35] Paragraph 20

[36] Paragraph 21

[37] *Beijing Sinozonto Mining Investment Co Ltd v Goldenray Consortium (Singapore) Pte Ltd [2014] 1 SLR 814*,

is more persuasive than that required in a claim for negligence because of the gravity and seriousness of the allegation

The jurisprudence on Arbitrability of fraud has seen a major transformation – from Russel where all fraud related cases were non-arbitrable to Avitel where the matters involve "public flavour to be kept outside the scope of arbitration. The issue of fraud has now to be observed from the facts of the case and then analysed to determine whether the particular frauds are Arbitrable or not."[38] The decision of Avitel is being followed by the courts now as can be seen in the recent cases of 2020 and 2021. The current stance of the judiciary can be understood from the following declaration made in *M/S N.N. Global Mercantile Pvt. Ltd. vs M/S Indo Unique Flame Ltd., 11 January 2021* -"the notion that allegations of fraud, forgery, or fabrication are non-arbitrable is a wholly archaic view and needs to be discarded."[39]

Although courts have done their best in dealing with arbitrability of fraud in 2021, it will be useful for the current stance to be embedded in the legislation so as to prevent future judges from deviating from this stance.

By setting a high standard for non-arbitrability, the judiciary has taken a pro-arbitration approach[40] and prefers to limit its interference in arbitration proceedings. This is in consonance with the "arbitration-unfriendly" outlook taken by the court in recent years. Other matters which saw such maturity on the part of Indian Courts are narrow scope of intervention in execution of foreign awards and limited scope of public policy applicable to foreign awards. These instances show significant effort being taken by the judiciary to put India on the map as a pro-arbitration jurisdiction. In my opinion, this pro-arbitration stance taken recently is much better than the earlier stance as it limits the interference in arbitration proceedings, reduces occurrences of people concocting false claims of fraud to delay arbitrations and will go a long way in making India the hub of arbitration.

[38] Saumya Vanwari, 'Arbitrability Of 'Fraud': Journey From 'Blanket Exclusion' To 'Public Flavour' (*Latest Laws*, 2021) <https://www.latestlaws.com/articles/arbitrability-of-fraud-journey-from-blanket-exclusion-to-public-flavour/#_ftnref12> accessed 10 September 2021.

[39] Supra note 16

[40] Supra note 24