Dispute Resolution Hotline

October 21, 2016

ALLEGATIONS OF FRAUD ARE ARBITRABLE – EVEN IN DOMESTIC ARBITRATIONS IN INDIA

The Supreme Court has held that:

- Allegations of fraud are arbitrable unless serious and complex in nature;
- *N. Radhakrishnan* did not make blanket exclusion of fraud from the purview of arbitration;
- *Swiss Timing* does not over-rule *N. Radhakrishnan* since it arose under Section 11 of the A&C Act;
- Issues of fraud are arbitrable unless the arbitration agreement itself is impeached.

INTRODUCTION

The Supreme Court of India ("Supreme Court"), in ***A. Ayyasamy (Appellant) v. A. Paramasivam & Ors. (Respondents)***[1] has held that disputes involving allegations of fraud arising out of contracts bearing an arbitration clause shall be referred to arbitration.

Distinguishing, yet not casting away, the oft-cited ruling of the Supreme Court in the case of *N. Radhakrishnan v. Maestro Engineers*[2] in matters involving arbitrability of fraud, a division bench of the Supreme Court has held that *N. Radhakrishnan* did not subscribe to the blanket proposition of non-arbitrability of fraud and that allegations which could be adjudicated upon in courts could also be adjudicated upon in arbitral proceedings, subject to certain carve-outs.

FACTS:

The parties entered into a partnership deed on 1 April 1994 for running a hotel. While the Appellant was entrusted with administration, the Respondents alleged that the Appellant had failed to make regular deposits of money into the common operating bank account and had fraudulently siphoned off an amount of INR 10,00,050. In a separate raid conducted by the CBI on premises of the Appellant's relative, an amount of INR 45,00,000 was seized and alleged to have been given by the Appellant for business of the hotel.

The Respondents filed a civil suit seeking right of administration of the hotel. The Appellant sought reference of the dispute to arbitration under Section 8 of the Arbitration & Conciliation Act, 1996 (**"A&C Act"**). The High Court rejected the Appellant's application on the ground that the dispute involved allegations of fraud. Aggrieved by the decision, the Appellant preferred an appeal before the Supreme Court.

CONTENTIONS OF THE RESPONDENTS:

The Respondents made the following contentions:

- The allegations constituted acts of fraud which were attributed to the Appellant.
- Where allegations of fraud are involved, civil courts are the appropriate forum for adjudication. The Respondents took recourse to judgment of the Supreme Court in *N. Radhakrishnan* wherein disputes revolved around serious malpractices, manipulation of accounts and cheating by the partners. The Supreme Court had held that since the allegations were serious and required evaluation of detailed evidence, they could "not be properly gone into by the Arbitrator".

FINDINGS OF THE SUPREME COURT

Minimum intervention by courts

The Supreme Court delved into the underlying objective of the A&C Act to minimize court interference in disputes involving arbitration. It held that Section 8 of the A&C Act mandated reference to arbitration unless, on a prima facie evaluation, the arbitration agreement was found to be invalid. It noted that Section 8 offered little discretion to courts to assume jurisdiction and made a conscious departure from the language of its equivalent provision under the UNCITRAL Model Law where reference could be rejected on wider grounds (viz. where the arbitration agreement was null and void, inoperative or incapable of being performed).

The Court held that Section 16 of the A&C Act also operated in the same vein while equipping the arbitrator to rule upon its own jurisdiction and minimizing court intervention. Further, the doctrine of separability (where the arbitration agreement survived nullity, even if embodied in a contract assailed on the grounds of fraud), helped to retain powers of the arbitral tribunal and adjudicate upon nullity of the contract. Thus, tribunals are vested with jurisdiction to consider issues of fraud.

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No demarcation of arbitrable and non-arbitrable disputes under the A&C Act

Noting that arbitrability is quintessential to ensure enforcement of awards and that the A&C Act is silent on types of non-arbitrable disputes, the Supreme Court outlined judicially enumerated issues which cannot be referred to arbitration - based on analysis of the types of rights involved (rights in rem or in personam), conferment of jurisdiction on special courts or on public policy. These include matters involving crimes, matrimony, insolvency and winding up, guardianship, tenancy, testamentary matters,[3] trusts[4] and consumer protection[5]. However, it held that the law did not exclude issues of fraud as being non-arbitrable.

N. Radhakrishnan is frequently misread

The Court held that *N. Radhakrishnan* involved serious allegations of fraud which necessitated evaluation of detailed evidence. This could only be done properly by Courts. However, the Supreme Court considered that in ruling so, *N. Radhakrishnan* had relied extensively on the judgment of *Abdul Kadir Shamsuddin Bubere v. Madhav Prabhakar Oak*[6] which arose under the Arbitration and Conciliation Act, 1940 - offering wide discretion to courts to assume jurisdiction. However, the A&C Act had limited court discretion and intervention under Section 8.

Despite the aforesaid observation, the Supreme Court did not expressly reject the reasoning in *N. Radhakrishnan* and held that serious allegations of fraud were non-arbitrable, while mere allegations of fraud would be arbitrable. It distinguished, by way of example, between simple and serious allegations of fraud. However, it emphasized that it was incumbent upon courts to sift through the materials and identify, on a prima facie basis, if the case involved allegations of a serious nature. Since the present dispute did not involve complex issues but merely matters of accounts, the Supreme Court held that the allegations could be easily ascertained by the arbitrator.

Swiss Timing does not over-rule *N. Radhakrishnan*

The Supreme Court considered the ruling in Swiss Timings Ltd. v. *Commonwealth Games 2010 Organizing Committee*[7] where a Single Judge of the Supreme Court held that *N. Radhakrishnan* (delivered by Division Bench) was per incuriam. The Supreme Court clarified that Swiss Timing dealt with Section 11(6) of the A&C Act which conferred power on the Chief Judge of India or the Chief Justice of the High Court as a designate to appoint an arbitrator. The exercise of power by the Court under Section 11 and the judgment so delivered could not be deemed to have precedential value. Therefore, it cannot be deemed to have overruled the proposition of law laid down in *N. Radhakrishnan*.

Reliance on foreign case law to focus on party intent

Relying on decisions of the UK courts[8], the Court held that it is inconceivable that ordinary businessmen would engage in a contractual tug of war by intending that questions of nullity of contract would be decided by the arbitrator while issues of fraud would be decided by the court. Arbitration is intended to be a one-stop forum unless parties expressly excluded certain disputes from its ambit. Therefore, unless the arbitration clause itself is impeached on grounds of fraud, the disputes will be capable of reference to arbitration. However, it was rare for a party to procure an arbitration agreement fraudulently, even in cases where the contract may have borne connection with fraud.

Multiple allegations of civil and criminal wrongdoing

Rejecting the general notion that elements of criminal wrongdoing or statutory violation detracted from the jurisdiction of the arbitral tribunal, the Supreme Court held that contractual power did not conflict with statutory power. Parties could exercise the power under the arbitration agreement; thereby giving teeth to the well accepted phenomenon of acceptance of criminal and contractual procedures[9].

ANALYSIS

The judgment is seminal in the arena of fraud related disputes arising out of contracts bearing arbitration clauses in India seated domestic arbitrations. In case of foreign seated arbitrations, the Supreme Court in *World Sport Group (Mauritius) Ltd. v. MSM Satellite (Singapore) Pte. Ltd.*[10] had held that allegations of fraud did not prevent the court from making reference to arbitration under Section 45 of the A&C Act. However, in the case of India seated domestic arbitrations, there was a cloud on efficacy of arbitral proceedings to resolve issues of fraud, particularly in light of the ruling in *N. Radhakrishnan*.

The present judgment sets to rest the conundrum created by *N. Radhakrishnan*. It recognizes that disputes which can be adjudicated upon by courts can, by default, be adjudicated upon by arbitral tribunals and that exceptions to this rule lie in limited frontiers of public policy, statutory legislation and rights in rem. It carefully pulls the rope bearing the weight of *N. Radhakrishnan* – its primary reliance on the judgment in *Abdul Kadir*. It clarifies that *N. Radhakrishnan* can be applied only where serious and complex allegations of fraud necessitating extensive evaluation of evidence are involved. Pursuant to this ruling, *N. Radhakrishnan* cannot be used for the purpose of making an unimpeachable statement on non-arbitrability of fraud, nor can it be used as a subterfuge to detract from jurisdiction of the arbitral tribunal by masking allegations as fraud. Every allegation of fraud would need to be weighed on a scale of seriousness and complexity, with an eye that sifts through material to identify veracity of the allegations.

The Court has also subtly stated that allegations of fraud can be adjudicated upon in courts when the person against whom such allegations are levelled desires to be tried in court. This will be an additional factor to be considered by courts in deciding applications for reference to arbitration. It will also be crucial for courts to scrutinize if fraud is directed at the arbitration agreement, thereby impeaching the agreement (and the resultant arbitration, the same being creature of the arbitration agreement), as contra-distinguished from the main contract.

The judgment acts as a fail-safe judgment as it takes into account universally-accepted principles of *kompetenz kompetenz*, separability and party autonomy as the epicenter of arbitration, and accords due respect to ordinary business rationale underlying arbitration clauses in contracts. It fortifies the intention of the judiciary to be a partner in arbitral proceedings and offer support, both in an active and passive manner, where questions arise with respect to reference to arbitration.

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[1] Civil Appeal Nos. 8245 and 8246 of 2016

[2] (2010)1 SCC 72

[3] Booz Allen & Hamilton vs. SBI Home Finance Ltd., (2011)5 SCC 532

[4] Vimal Kishore Shah vs. Jayesh Dinesh Shah, Civil Appeal No. 8614 of 2016

[5] Skypak Courier Ltd. Vs. Tata Chemical Ltd., (2000)5 SCC 294

[6] AIR 1962 SC 406

[7] (2014) 6 SCC 677. Our analysis of the judgment can be viewed here

[8] *Fiona Trust & Holding Corporation vs. Yuri Privalov* (2007)1 AllER (Comm) 891*; Premium Nafta Products Ltd. vs. Fily Shipping Co. Ltd.* (2007) UKHL 40

[9] Hindustan *Petroleum Corporation Ltd. Vs. Pinkcity Midway Petroleum*, (2003) 6 SCC 503

[10] AIR 2014 SC 968; Our analysis of the judgment can be viewed here

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