

ARBITRABILITY OF FRAUD: A DETAILED ANALYSIS

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INTRODUCTION

An arbitration is a method of resolving disputes through an arbitrator appointed by the parties in a dispute¹. It is a voluntary process, where parties to the dispute on mutual consent shall refer the dispute to a third party for his decision². In India, the Arbitration and Conciliation Act, 1996 deals with the law related to arbitration. The Act is in line with the 1985 UNCITRAL Model Law on International Commercial Arbitration and the UNCITRAL Arbitration Rules 1976. Prior to the enactment of this Act, the law which governed arbitration process in India was governed by a 1940 Act, which was often criticized for its provisions which conferred limited power to the arbitral process as it often afforded multiple opportunities to litigants to approach the court for intervention.

Honourable Supreme Court of India, has expressed its views on the new Act in *Konkan Railway Corporation v Mehul Construction Co.*³ as; To attract the confidence of International Mercantile community and the growing volume of India's trade and commercial relationship with the rest of the world after the new liberalization policy of the Government, Indian Parliament was persuaded to enact the Arbitration & Conciliation Act of 1996 in UNCITRAL model and therefore in interpreting any provisions of the 1996 Act, Courts must not ignore the objects and purpose of the enactment of 1996. A bare comparison of different provisions of the Arbitration Act of 1940 with the provisions of Arbitration & Conciliation Act, 1996 would unequivocally indicate that 1996 Act limits intervention of

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¹ Vishnu S Warriar, Quick Reference Guide on Arbitration Conciliation and Mediation (2015), LexisNexis, p. 2

² Vishnu S Warriar, Arbitration Conciliation and Mediation (2015), LexisNexis, p. 12

³ 2000 (7) SCC 201

Court with an arbitral process to the minimum.

Because of the new legislation and subsequent observations by the court, the current scenario of Arbitration in India is that if the parties have a valid agreement with regards to arbitration, the Court can't interfere into the context of the Agreement except in certain situations, and is bound to refer the dispute to Arbitration. Section 8 of the Act stresses on this aspect, provided the non - applicant objects no later than submitting its statement of defense on merits. The Act does not expressly mention the subject matters, which come under the purview of arbitration, nor does it mention matters, which are non-arbitrable. As per the generally followed principle, any commercial matter including an action in tort if it arises out of or relates to a contract can be referred to arbitration. However, the Honourable Supreme Court in **Booz Allen and Hamilton Inc, Vs SBI Home Finance Ltd & Ors**⁴ has set out some examples of matters, which are non-arbitrable, which includes,

- 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.

In the case of *Vimal Kishore Shah v. Jayesh Dinesh Shah*⁵, the court added the seventh category to the six non-arbitrable categories set out in Booz Allen case, which was relating to trusts, trustees and beneficiaries arising out of trust deed and the Trust Act. In the case of *Kingfisher Airlines Limited v. Prithvi Malhotra Instructor*⁶, the court held that the test would be whether adjudication of such disputes is reserved exclusively for public fora as a matter of public policy. Because even an action-in-personam, if reserved for public fora as a matter of public policy, would be non-arbitrable. Hence, a two-fold test is said to exist while determining whether an issue would come under the purview of arbitration or not.

However, whether an issue-involving allegation of fraud is a subject to arbitration or not is was always a matter of discussion for

⁴ AIR2011SC2507

⁵ (2016)8 SCC 788

⁶ 62 2013 (7) BomCR 738

many years. The position is almost well settled with in English Law. In UK, according to Section 24(2) of the Arbitration Act 1950, the Court could review the authority of a tribunal to deal with a claim involving allegations of fraud and determine those claims itself. A famous judgment in this regard is worth mentioning ie. Russel Vs. Russel⁷, where the court observed that “*in a case where fraud is charged, the court will in general refuse to send the dispute to arbitration if the party charged with the fraud desires a public inquiry.*”

However, the new act of 1996 does not contain such provisions and the tribunal has the jurisdiction to deal with such issues. Arbitrations with their seat in England benefit from powers exercisable by the Court in support of arbitral proceedings. These include the taking of the evidence of witnesses, the preservation of evidence, making orders relating to property, which is the subject matter of the proceedings and the granting of interim injunctions to preserve assets. However, the Indian position with regards to arbitrability in case of allegations of fraud has always been an area of ambiguity.

It can be said that the debate started with the case of **Abdul Kadir Shamsuddin Bubere v. Madhav Prabhakar Oak**⁸. In this case, the apex court said that where serious allegations of fraud are made against a party;

and the party who is charged with fraud desires that the matter should be tried in open court, then court will have sufficient cause under section 20 of the Arbitration Act, 1940 to refrain from referring the matter to the arbitral tribunal.

There are certain notable judgments which came after the enactment of the 1996 Act, which aggregated the ambiguity with respect to the issue of fraud being arbitrable or not.

N. Radhakrishnan v. Maestro Engineers and Ors.⁹ Is one of such famous cases, where the court followed the lines of Abdul Kadir's case and decided that the case will be non-arbitrable if it involves allegations of fraud and serious malpractices? The decision was pronounced by a Two-judge bench of the court and it had various implications in the judgments followed. However, this view was altered by the honorable court in the case of **Swiss Timing Limited v. Organising Committee, Commonwealth Games 2010**¹⁰, the hon'ble apex court opined that the principle formulated in the case of N. Radhakrishnan is '*per incuriam*'. One interesting fact about this judgment is it is delivered by a single bench whereas the judgment of N. Radhakrishna flowed from a two-judge. The court in this case has taken due consideration to the , the concept of separability of the arbitration clause/agreement from the underlying

⁷ [1880] 14 Ch.D. 471
⁸ 63 AIR SC 1962 406

⁹ 64 (2010) 1 SCC 72
¹⁰ 65 (2014) 6 SCC 677

contract has been statutorily recognised Under Section 16 of the Arbitration Act, 1996.

The 246th law commission report also talks about this issue of arbitrability of fraud and states as: “*The Commission believes that it is important to set this entire controversy to a rest and make issues of fraud expressly arbitrable and to this end has proposed amendments to section 16.*” However, no such amendments to section 16 in favour of the process of arbitration can be seen even after an amendment to the Act in 2015. The Supreme Court’s Decision in **Ayyasamy v. A. Paramasivam and Ors**¹¹ has to an extent, minimized the confusions arising out of discrepancies in views by different benches of the apex courts and various High Courts. The facts of the case can be summarized as follows;

A dispute arose on account of allegations of fraud and embezzlement against the Appellant in managing a hotel. The parties were brothers who were partners for running a hotel along with their father. After the death of their father, the eldest brother, ie., the appellant was entrusted by the other partners to carry out the day to day business and deposit the daily collection in a current account in the name of the hotel. Some fraud was alleged to be committed by the appellant and the respondents filed for an injunction before a civil court for preventing the Appellant from managing the affairs of the

hotel. The Appellant filed an application under Section 8 of the Arbitration and Conciliation Act, 1996 for referring the dispute to arbitration given the arbitration agreement between the parties. The Respondents raised fraud as a ground to argue that the civil court was an appropriate forum to adjudicate this matter. The lower court followed *Radhakrishnan* and dismissed the plea for referral of the dispute to an arbitral tribunal. This was upheld by the Madras High Court. In appeal, the Supreme Court considered the issue whether mere allegations of fraud render disputes non-arbitrable.

The Supreme Court acknowledged that the previous decisions had identified fraud as one of the categories for considering disputes non-arbitrable. However, it distinguished between mere allegations of fraud and serious cases of fraud. The Court held that disputes involving mere allegations of fraud are arbitrable, except when such allegations are of a serious, complex nature, which would warrant examination of extensive and voluminous evidence. It recognized that alleging fraud was a convenient mode for parties to avoid arbitration.

The court also observed the following:

- The A&C Act, does not make any specific provision which excludes any category of disputes terming them to

¹¹ Civil Appeal Nos. 8245 and 8246 of 2016

be non-arbitrable and it has been laid down in numerous cases that the scope of judicial intervention, in the cases where there is arbitration clause which is clear and unambiguous, would be very limited and minimal. As, section 8 contains a mandate that were an action is brought before a judicial authority, where the subject is of an arbitration agreement, the parties shall be referred to the arbitration. The only exemption to this is when the authority finds prima facie that there is no valid arbitration agreement.

- Section 16 empowers the arbitral tribunal to rule upon its own jurisdiction, including ruling on any objection with respect to the existence or validity of an arbitration agreement. As per Section 16(1), the decision of arbitral tribunal that a contract is null and void shall not mean that the arbitration agreement is also null and void. The arbitration agreement or clause is treated as a separate agreement than the contract.
- Section 34(2)(b) and Section 48(2) provide as one of the grounds for challenge in respect of the enforceability of an award on the ground that the dispute is not capable of settlement by arbitration under the law for the time being in force.

- From the combined readings of section 5, 16 and 34 of the A&C Act, it can be inferred that it has to be shown that there is a law which makes subject matter of a dispute incapable of settlement by arbitration and according to section 5 of the act, it is clear that there should not be any judicial intervention if there is a valid arbitration agreement between the parties. Also the validity of the arbitration agreement/clause has to be decided by the Arbitral Tribunal only (As per Section 16 of the Act).

The Court concluded that the allegations were not serious in nature, reversed the High Court's decision and appointed an arbitrator.

The judgment is seminal in the arena of fraud related disputes arising out of contracts bearing arbitration clauses in India seated domestic arbitrations. The Supreme Court also drew the difference between allegation, which are simple in nature, and the allegations, which demand evidence, which is complex in nature and requires to be proved beyond reasonable doubt, which can only be done by civil court and not by an arbitrator. Therefore, the matters of fraud, which are not so complex and are just mere allegations, would be arbitrable and the court is bound to refer those matters to arbitrator.