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ARBITRABILITY OF FRAUD DISPUTES IN INDIA: A CHANGE IN THE JUDICIAL TREND

Introduction

The Arbitration and Conciliation (Amendment) Act, 2015[1] marked a significant step in reforming the process of alternate dispute resolution in India. However, there are certain provisions on which the court has taken contradictory positions in different cases. Since arbitration is a relatively nascent forum for adjudication of disputes, the powers of the arbitral tribunal and courts have clashed at times, which has led to this demarcation becoming blurry. While the essence of arbitration is to lessen the pendency in courts and help in amicable resolution of disputes, the courts at times have attempted to impose their authority over such tribunals and in the interests of justice. However, in the recent past, courts have welcomed certain arbitration practices. While there are a number of issues of conflict, this paper seeks to highlight a situation where courts have acknowledged the efficacy of arbitral tribunals and have in fact encouraged it.

This paper focuses, in particular, on Section 11(6A)[2] through a series of chronological case law, to portray the pro-arbitration stance adopted by High Courts and the Supreme Court. It shows how courts were earlier a bit hesitant to divest themselves of this power. But recently, the Supreme Court has carefully balanced the power to be given to arbitral tribunals on one hand, and the power to adjudicate upon certain matters itself on the other .

The Initial Position

In *N. Radhakrishnan v Maestro Engineers & Ors.* [3] the Supreme Court of India heard a matter in appeal from the High Court. In this case, the appellant and the respondent had entered into a partnership agreement for the functioning of the firm, named 'Maestro Engineers'. Disputes arose and a notice was sent to the respondent regarding their conduct in business.

Though it is not clear whether a malpractice always amounts to fraud, parties can argue it to be a vitiating factor in an agreement. Here, malpractice and collusion was contended by the appellants. In the case, inaccurate figures with regard to the amount of capital invested were mentioned. Averments of collusion were also present, which included account-forging, and driving out clients from the firm. The case, though, was germane because of the battle regarding which forum was capable of deciding this matter. The suit filed by the appellant was dismissed by the District Court and the Madras High Court. They had rejected the arguments made the appellant and had opined that issues related to fraud cannot be decided by the arbitrator and must be done by the courts itself. The apex court too, agreeing with para 17 of *Abdul Kadir Shamsuddin Bubere v. Madhav Prabhakar Oak & Anr.*,[4] which read "There is no doubt 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, that would be a sufficient cause for the court not to order an arbitration agreement, which had been entered into in this case, to be filed and not to make the reference.....".[5] (However, the leeway provided by this judgment was deemed to be excessive and was said to be cut down by Section 8 the Amendment Act[6] [7], in the SC judgment of 2016 mentioned later on). Relying on other judgements cited as well, the court held that allegations as serious as those in the present case could not be resolved by an arbitrator and that court intervention was needed. It also said that Section 8(2) of the statute[8], referring to an arbitration agreement, had not been complied with and accordingly upheld the judgment by the lower courts. The position, up until the following decision, was for adjudication of fraud disputes to take place in a court of law and to be an issue not to be decided by an arbitral tribunal.

A Shift in the Court's Position

In 2014 however, the Supreme Court of India in *Swiss Timings Co. v. Commonwealth Games Organizing Committee*[9] took a complete U-turn (from its position of fraud disputes being of non-arbitrable nature) and stated that even disputes pertaining to fraud are arbitrable.[10] For the purposes of this paper, it is germane to look at the *ratio decidendi* of the apex court. A petition under Section 11(4) and 11(6) was the Act[11] was filed. The Respondent wanted a nominee arbitrator to be appointed and wanted the arbitral tribunal to be headed by that presiding arbitrator. While Justice S.S. Nijjhar did hold that proceedings of fraud would be arbitrable, the court also stressed on certain other points of extreme significance.

It opined that when the main contract is *void ab initio*, it would be impossible for the court not to exercise jurisdiction under Section 11 of the Act.[12] He also said that the N. Radhakrishnan judgment[13] ran contrary to the *Hindustan Petroleum Corporation Ltd.* v. *Pinkcity Midway Petroleums*[14] wherein it was held that if an arbitration clause is present in the agreement, then the civil court was bound to refer the matter for arbitration. It thus held the the N. Radhakrishnan judgment[15] to be without due regard to the law or facts. The reason why this judgment is so important is because the court examined the reasons for the arbitral tribunal to decide matters related to arbitrability of fraud and said that the matter ought to be referred to arbitration. It also gave a certain authority to courts to deal with matters of this kind, which they were, in my view, a bit hesitant on, due to the lack of clarity in the law.[16]

The Delhi High Court continued with this approach adopted by the apex court, in *Picasso Digital Media Pvt. Ltd. v Pick-A-Cent Consultancy Service Pvt. Ltd.*[17] Here, the petitioner (Picasso) and the respondent (Pick-A-Cent) agreed to a Memorandum of Understanding (MoU) on July 1 2009, according to which the petitioner agreed to transfer a franchisee of 'Picasso Animation College' at Bangalore. A clause in the agreement explicitly stated that any disputes arising out of this mutual agreement, shall be referred to a sole arbitrator. Moreover, this claim was not denied by the Respondent. But, the respondent alleged misrepresentation by the petitioner on the transfer of ownership of intellectual property between the parties. There was also a dispute regarding the appointment of a sole arbitrator.

Moreover, this claim was not denied by the Respondent. But, the respondent alleged misrepresentation by the petitioner on the transfer of ownership of intellectual property between the parties. There was also a dispute regarding the appointment of a sole arbitrator. The counsel for the Respondent placed strong reliance on N. Radhakrishnan[18] to stress that when there are allegations of fraud involved, the forum to go to is the court and not the arbitral tribunal. However, Justice Muralidhar of the Delhi High Court categorically rejected that contention and stated that the case relied on by the respondents was one before the 2015 Amendments to the Act.[19] The Court said that Section 11(6A) of the amended Act[20] requires the court, while deciding such issues, to confine it the existence of the arbitration agreement of the dispute. In other words, the court welcomed the provision that chose arbitral tribunal over a court in such matters. It decided that despite it being a case of fraud, the sole arbitrator will decide the matter[21] [22]

But the most important contribution of this judgment has been its acknowledgement and consequent application of the principle of *competence-competence*, whereby arbitral tribunals should be allowed to decide their own jurisdiction, in line with the UNCITRAL Model Law.[23] [24] This gives the tribunal to decide its own jurisdiction and if there is any error in this decision, the courts can intervene. The important caveat to this law is that courts are well within their powers to intervene if it is a pure issue of law.[25]

This approach was in operation for some time, until the fear of moving back to the Radhakrishnan[26] era sprung due to the *RRB Energy Limited v. Vestas Wind Systems*[27] as the Delhi High Court imposed an anti-arbitration injunction on the ground that the issue was non-arbitrable.[28] There was also a doubt with regard to what constitutes a fraud and whether or not it is serious enough in certain cases or not, which the court may misinterpret. This dilemma has been faced by courts since fraud is a concept which is very subjective and no definitive criteria can be set up to adjudicate it. In other words, it has to be looked at from a case to case basis.

The Final Intervention

On October 4, 2016 the Supreme Court of India , in *A. Ayyasamy v. A. Paramasivam & Ors.*[29] settled the issue and held that a dispute must be referred to arbitration unless the fraud is of a serious and complicated nature, such as those involving financial malpractices or criminal wrongdoings. The division bench comprising of Justice A.K. Sikri and Justice D.Y. Chandrachud also held that a mere allegation of *fraud simplicitor*, like cases of tricking or duping someone else, would not be sufficient in ousting the jurisdiction of an arbitral tribunal. Thus, the court has gone one step further in advocating this pro-arbitration approach and adding lucidity in the law. The facts of this case were: a partnership firm running a hotel business was run by five brothers after the death of their father, and they were also partners in the firm. A dispute arose as one of the brothers, by way of a check, transferred money to his son's account rather than in the account of all the partners.

The other partners filed a declaratory suit in the local civil court, and prayed for the court to hold that they had a right to participate in hotel administration and asked for a permanent injunction against the partner. In response, the appellant raised the contention that the dispute ought to be referred to arbitration under Section 8 of the Act[30] due to the presence of an arbitration clause in the agreement. The respondents pleaded that an issue of fraud could be decided by the court as well. But the District court dismissed the petitioner's contentions. The High Court too concurred with the findings of the District Court, and the matter came before the apex court by way of a special leave petition. The court held that that there was no provision declaring certain issues to be non-arbitrable as such in the statute. It was also stated that it would ordinarily not intervene in the presence of an arbitration agreement and that a certain amount of trust ought to be placed on the tribunal.

"The judgment in *Booz Allen*[31] and the 246th Law Commission Report[32] were referred to by Justice Sikri on behalf of the Division Bench while discussing whether the present dispute was capable of adjudication and settlement by arbitration. The latter had propagated the need for fraud-related issues being made arbitrable, except on certain specified grounds.

The order in *Booz Allen*[33] held that only where the subject matter of the dispute fell exclusively within the domain of courts, could the dispute said to be non-arbitrable. In general, a right *in rem* (on issues of ownership or possession available against the world at large) would not be arbitrable but a right *in personam* (on issues like debt recovery and defamation involving a person or class of persons) would be capable of adjudication in private fora."[34]
However, the court did lay down a list of non-arbitrable disputes[35]:

•disputes relating to rights and liabilities which give rise to or arise out of criminal offences;
•matrimonial disputes;
•guardianship matters;
•insolvency and winding up;
•testamentary matters;
•eviction or tenancy matters; and
•disputes *inter se* between trust, trustees, and beneficiaries.

The Supreme Court[36] has held that a court can proceed on the merits of a case and disregard claims made under Section 8[37], when -

i. when there is a serious allegation of fraud which makes it a criminal offence, or
ii. when the allegation of fraud becomes so complicated that it becomes necessary to consider complex issues wherein extensive evidence is required to be produced by the parties for the determination of the offence by the court, or
iii. where fraud is alleged against the arbitration provision itself or is of such a nature that permeates the entire contract, including the arbitration agreement, meaning thereby in those cases where fraud goes to the validity of the contract itself of the entire contract which contains the arbitration clause or the validity of the arbitration clause itself.[38]

The bench opined that only in very serious cases of fraud which require the intervention by the court would it adjudicate upon it. This would include, for instance – criminal acts in the case being discussed. It said that frivolous allegations of fraud ought to be avoided. Another important observation made by the court was on the doctrine of separability, wherein it held that the fact whether the arbitrator had powers to decide upon the matter, is distinct from the main contract in dispute. The Court also suggested that parties could mention non-arbitrability of that particular dispute to arbitration, which would make the issue much easier for the courts as to the intention of the parties. Otherwise, the approach of minimal court interference was enunciated except if the arbitration agreement itself was invalid. However, there is no straitjacket formula for constituting fraud and the courts evidently prefer to leave it open-ended.

Analysis of The Judicial Timeline of Arbitrability Of Fraud

It is argued that the legislature ought to have made it clearer as to what constitutes an issue of fraud and has missed a golden chance to do so. However, to have a statute expressly stating the grounds may have proven to be counter-productive as such issues cannot be put in a set of conditions. What constitutes a fraud needs to be looked at from a case to case basis. Thus, the court has left it partially open-ended but at the same time, has cleared the controversy with regard to arbitrability of fraud disputes. This is a beneficial aberration as usually, courts want to preserve their supremacy and have been seemingly threatened by the rise of myriad arbitration fora. They also doubt the competency of arbitral tribunals in matters of such a complicated nature. However, courts have themselves seen that such issues are better dealt with when referred to arbitration. This is because alongside respecting the decision of the parties, certain issues can be easily referred to arbitration. Another significant advantage is the prevention of dilatory tactics that were used by parties through this complaint. It is only in certain situations will the courts look at the question of fraud in an otherwise valid agreement. The argument here is that although courts should have the power to determine whether tribunals are a competent forum or not, the approach should not be rigid. The danger is that though court is limiting the power and questioning the competence of tribunals to arbitrate on these serious issues, and in a way undermining their authority. The court ought to have taken this opportunity to expand the ambit of arbitral tribunals and their awards.[39] Another problem that surfaces is that civil courts are forced to decide on the arbitrability of disputes as there are no guidelines to aid them in deciding if the fraud is of a nature that necessitates court intervention or not. Judicial overreach is thus another portended flipside of this interpretation.[40]

Conclusion

The bone of contention, regarding the application of Section 8, has revolved around the court referring the matter to arbitration. The amended provision seeks to put party autonomy on a higher pedestal and says that despite any court order, parties have a right to pursue arbitration. Only in cases where *prima* facie no arbitration agreements exists can the court proceed with the matter. But all in all, the Act and its interpretation of this section, has laid open the doors for arbitration in India in another major way, by paving the way and introducing clarity on the issue. Arbitral tribunals, particularly investment arbitrations, involve these allegations. Till date, it is not absolutely clear how tribunals are supposed to adjudicate on such claims. Usually, these claims are not paid heed to at the jurisdictional phase. This is because there is no point considering these allegations if the court lacks jurisdiction. They are decided upon when the court looks at the merits of the cases. But it is safe to say that by striking a balance and accepting the universal principles of arbitration, the courts are acting as a protector and not a hindrance in the emergence of arbitral competency.

Endnotes –

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