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ARBITRABILITY OF FRAUD UNDER THE ARBITRATION AND CONCILIATION ACT, 1996, AS AMENDED



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A Fraud

- 1 Fraud is understood as wrongful or criminal deception intended to result in financial or personal gain.
- 2 Under the criminal law in India, fraud has not been expressly defined, however, the essence of the provisions dealing with fraud stipulates that fraud is an act of deliberate deception amounting to a wrongful gain or an unfair advantage.
- 3 Intention and deception are two important components of fraud as opposed to negligence.
- 4 Under the civil law, fraud is defined in the Indian Contract Act, 1872 (ICA).
- 5 Section 17 of the ICA, defines fraud to include:
 - Suggestion of a fact which is not true by the one who believes that it is not true.
 - Active concealment of a fact by the one who has knowledge of the same.
 - Promise made without any intention of performing it.
 - Any other act that can be deemed fit to deceive.
 - Any other act or omission that the law specifically declares to be fraudulent.
- 6 In the present context, it is relevant and important to deal with and understand what is meant by commercial fraud.
- 7 The United Nations Commission for International Trade Law states that a strict legal definition of commercial fraud may not be sufficient in highlighting its nature and objectives. It rather lays down the main elements for identification of commercial fraud, which are:
 - Deceit, providing inaccurate, incomplete or misleading information;
 - Reliance on the deceit which affects a legal right;
 - Economic dimension and scale;
 - Use, misuse, compromise or distortion of commercial legal systems and their legitimate instruments; and
 - A resultant loss of value.

B Arbitrability

- 1 Having dealt with the various facets of fraud, it is now central to the present subject to understand what is

arbitrability.

- 2 Arbitrability means the affirmation that a certain subject matter/dispute may be adjudicated through arbitration i.e. that the same within the jurisdiction of the Arbitral Tribunal to adjudicate upon.
- 3 The two main factors that determine arbitrability are the arbitration clause/agreement and the nature of the dispute.
- 4 *Booz Allen and Hamilton Inc vs. SBI Home Finance Ltd. [(2011) 5 SCC 532]*, lists down that matters involving testamentary issues, tenancy, eviction, winding up, insolvency, matrimony, guardianship and crimes are non-arbitrable. *Vimal Kishor Shah vs. Jayesh Dinesh Shah [(2016) 8 SCC 788]*, added a seventh category; cases arising out of trust deed and Trusts Act.
- 5 The question of arbitrability of fraud seeks to answer whether the Arbitral Tribunal under the Arbitration and Conciliation Act, 1996 as amended by the Arbitration and Conciliation (Amendment) Act, 2015 (hereinafter referred to as the Act) can adjudicate disputes that involve an element of fraud.

C Power of tribunal prior to 2015 amendment

- 1 The Act does not specifically define fraud or lay down the rules as to arbitrability of fraud.
- 2 Prior to the amendment of 2015, the law as regards the arbitrability of fraud was majorly based on the judicial precedents.

D Power of tribunal post 2015 amendment

- 1 Post the amendment of 2015, nothing much has changed as regards the Act. The position in the statute stands at the same place.
- 2 However, amendment of Section 8 of the Act which stipulates that reference to arbitration shall be mandatory if there exists an arbitration agreement/arbitration clause, has put the burden of application for the same upon the parties.
- 3 Section 8 is significant for the underlying criterion that

an arbitration agreement must prima facie exist for the parties to resort to arbitration irrespective of the presence or absence of the element of fraud in the dispute or in the agreement itself.

- 4 Section 16 of the Act is also relevant as it states that it is within the powers of the arbitral tribunal to rule on its own jurisdiction.

E Development of the law vis-à-vis decisions of the Courts

- 1 The first decision in this context was passed in *Abdul Kadir Shamsuddin Bubere vs. Madhav Prabhakar Oak* [AIR 1962 SC 406] wherein a three-judge bench of the Supreme Court held that issues/allegations of fraud of serious nature are not arbitrable since it involved complex factual questions.
- 2 *N. Radhakrishnan vs. Maestro Engineers* [(2010) 1 SCC 72] followed the ruling in Abdul Kadir and the Supreme Court held that,
 - Despite existence of arbitration agreement, the dispute may be tried by a court if it requires detailed investigations and production of elaborate evidence; and
 - The court would be more competent to have the means to decide such a complicated matter.
- 3 This decision was discarded and rejected in the backdrop that it failed to recognize the pro-arbitration approach that the courts were moving towards.
- 4 *In Swiss Timing Ltd. vs. Commonwealth Games 2010 Organising Committee* [(2014) 6 SCC 677],
 - the Court sought to correct the mistake made in the past,
 - placed reliance on Section 8 of the Act,
 - concluded that when a judicial authority is faced with a case that is based on an arbitration agreement, it is the duty of such authority to refer the dispute to arbitration.
 - Held, registering of a criminal case on grounds of fraud, in relation to the agreement concerned, is not an absolute bar to refer disputes to arbitration.
- 5 The point as to what kind of fraud would be plausible to be referred to arbitration was clarified in the celebrated decision of *A. Ayyasamy vs. A. Paramasivam* [(2016) 10 SCC 386].
- 6 J. Chandrachud in this decision supplemented that since the statute does not specifically exclude any category of dispute as non-arbitrable, mere allegation of fraud shall not close the doors of arbitration for the parties.
- 7 In *Ayyasamy*, a distinction was made between simpliciter allegations of fraud and serious allegations of fraud, the latter being held non-arbitrable. The serious allegations of fraud for non-arbitrability shall be decided on the basis of the twin-test, being-
 - The plea of fraud renders the entire contract and more importantly, the arbitration agreement void; and
 - The allegation of fraud has an implication on the public domain.
- 8 An element of fraud in the common law system is generally in rem. However, when such element does not affect the rights of the public at large and is only *in personam*, it may be arbitrable.
- 9 In *Avitel Post Studioz Ltd. vs. HSBC PI Holdings (Mauritius) Ltd.* [2020 SCC OnLine SC 656] the Supreme Court followed/affirmed the twin test laid down in *Ayyasamy*.
- 10 However, the question of deciding whether an allegation of fraud is simple or serious in nature still needs to be adjudicated on a case-to-case basis.
- 11 In a most recent development of December 14, 2020, in *Vidya Drolia vs. Durga Trading Corporation* [2020 SCC OnLine SC 1018], the Supreme Court came to the following conclusions:
 - The judgment in *N. Radhakrishnan* was overruled.
 - It was held that allegations of fraud relating to civil dispute may be adjudicated through arbitration.

- A caveat was provided to the effect that when fraud vitiates or invalidates the arbitration clause, it shall be an aspect relating to non-arbitrability.

F The future road-map

- 1 The 246th Law Commission Report had recognized that there exists a gap on the issue of arbitrability of fraud owing to conflicting decisions and diverging views of the Apex Court, which should be remedied through an amendment of Section 16 (Competence of arbitral tribunal to rule on its own jurisdiction) of the Act. Such recommendation was not considered.
- 2 In a positive approach, the Arbitration and Conciliation (Amendment) Ordinance, 2020 was passed through presidential consent on 4th November, 2020 which provides for issue of stay on the execution of an award unconditionally when it involves an element of fraud.
- 3 As the law has evolved, in terms of the present developments, it can be construed that fraud is arbitrable with certain exceptions of “serious allegations” which cannot be resolved through arbitration (*Avitel vs. HSBC*).
- 4 The test of serious allegations and thereby determining arbitrability shall be within the jurisdiction of the Arbitral Tribunal and decision upon the same may be taken under Section 16 of the Act
- 5 The object of arbitration is to promote quick and out-of-court settlement of disputes. If commercial fraud is held not arbitrable, then the object of arbitration will be defeated. Thus, the position as it stands now is a welcome development.