

Dispute Resolution Hotline

June 06, 2014

INDIA - ARBITRATION FRIENDLY- ALLEGATIONS OF FRAUD AND CORRUPTION NO BAR TO ARBITRATION!

The Supreme Court has held that:

- Allegations of fraud and other malpractices are arbitrable.
- *N. Radhakrishnan case* does not lay down the correct law
- Contention of substantive contract being void / voidable is not a bar to arbitration and the court must follow the policy of least interference
- Arbitration and criminal proceedings may continue simultaneously

INTRODUCTION

The Supreme Court of India, in *Swiss Timing Limited ["Petitioner"] v. Organising Committee, Commonwealth Games 2010, Delhi ["Respondent"]*, has now held that the allegations of fraud can be determined by arbitration where an arbitration agreement exists between the parties. This sets a new, pro-arbitration tone to the issue of arbitrability of allegations of fraud in Indian seated arbitrations.

Previously, the Supreme Court, in *N. Radhakrishnan v. Maestro Engineers & Ors.*² [*"N. Radhakrishnan case"*], had followed a conservative approach and held that serious allegations of fraud were to be determined by courts and not arbitral tribunals, if the party against whom such allegations were made so desired.

FACTS

The Petitioner, a Swiss company, entered into an agreement [*"Contract"*] on March 11, 2010 with the Respondent for providing timing, score, result systems and supporting services required to conduct the Commonwealth Games in India. The Petitioner alleged that the Respondent had defaulted in making the payments due under the Contract. The Petitioner invoked arbitration under clause 38 [*"Arbitration Agreement"*] of the Contract. As the Respondent failed to nominate its arbitrator, the Petitioner approached the Supreme Court under Section 11³ of the Arbitration and Conciliation Act, 1996 [*"Act"*] for constitution of the arbitral tribunal.

OBJECTIONS RAISED BY THE RESPONDENT

The Respondent, amongst other issues, raised the following primary objections:

- Under the Contract the parties had warranted that they would not indulge in corrupt practices to induce the execution of the Contract. The Respondent contended that the Petitioner had procured the Contract by indulging in corruption and hence, the Contract was void since its very inception (*void ab-initio*) and there was no basis for invoking the arbitration.

Interestingly, the Respondent, to establish corruption during execution of the Contract, sought to rely on the pending criminal proceedings initiated against Mr. Suresh Kalmadi (the then Chairman of the Respondent) and other officials of the Respondent on the allegations of corruption, cheating and commission of other fraudulent acts.

- The Respondent further placed reliance on the *N. Radhakrishnan case* wherein it was held that allegations of fraud and serious malpractices cannot be dealt with properly in arbitration.
- Lastly, the Respondent argued that since the criminal proceedings were pending in the trial court, simultaneous continuance of the arbitration could result in conflicting decisions between the two forums causing unnecessary confusion.

FINDINGS OF THE SUPREME COURT

Fraud held arbitrable - *N. Radhakrishnan case* held *per incuriam*

The Court has clearly held that the judgment in the *N. Radhakrishnan case* did not lay down the correct law as it failed to duly consider the earlier judgments of the Court in *Hindustan Petroleum Corp case*⁴ and *Anand Gajapathi Raju case*⁵, wherein it has been held that a civil court is obligated to direct parties before it to arbitration where there exists an arbitration agreement between such parties.

The Court further cited non-consideration of Section 16⁶ of the Act, as reason for the incorrectness of the law laid down in *N. Radhakrishnan case*. It was affirmed that by virtue of Section 16 and the frame of the Act, an arbitration clause is treated as independent from the underlying contract. Section 16 further provides that a decision by the

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arbitral tribunal holding the contract as null and void would not lead to the invalidity of the arbitration clause contained in such a contract.

It was emphasized that parties cannot be permitted to avoid arbitration unless they satisfy that doing so will be just and in the interest of all the parties.

Contention of substantive contract being void / voidable is no bar to arbitration

The Supreme Court highlighted that the courts should adopt a least interference policy in keeping with the general principle under Section 5 of the Act. Having jointly read Sections 5⁷ and 16 of the Act the Supreme Court held that all matters including the issue as to whether the main contract was void / voidable can be referred to arbitration.

Importantly, the Supreme Court has provided clarity on how objections regarding invalidity of the contract as bar to reference to arbitration have to be dealt with. It has been held that where a court may conclude that a contract is void without receiving any evidence, the court would be justified in declining a reference to arbitration, though such cases would not be common. Examples of situations where a court may reach such a conclusion without requirement of any evidence and upon reading of the contract would be in situations of wagering agreements, where both parties are under mistake of fact or where the consideration or object is forbidden by law. Drawing a distinction between void and voidable contracts, the Supreme Court highlighted that in cases where the defense taken is that a contract is voidable, it would not be possible to decline reference to arbitration. Such cases would include unsoundness of mind, coercion, fraud, undue influence and misrepresentation.

Accordingly, in respect of the Respondent's contention that it had the right to terminate the Contract as the Contract had been executed by corrupt means, it was held that these contentions would have to be established in a proper forum on the basis of the oral and documentary evidence, produced by the parties, in support of their respective claims. A mere claim of the Contract being void would not suffice.

Interestingly, the Supreme Court has made an observation that defense of the contract being void is routinely taken to delay reference to arbitration and that such grounds should be summarily rejected unless there is clear indication of reasonable chance of success.

Arbitration and criminal proceedings may continue simultaneously

The Court rejected the contention of the Respondent that the arbitration should not be commenced pending the adjudication of the criminal proceedings against the officials. The court held that the possibility of conflicting decisions is not a bar against simultaneously proceeding with arbitration and criminal proceedings. The Court relying on the judgment of *MS. Sheriff v. State of Madras*⁸, has held that the solitary consideration to restrain simultaneous civil and criminal proceedings is the likelihood of embarrassment to the accused.

Lastly, the Court highlighted that if the criminal proceedings result in an acquittal, it would leave little ground for challenging the validity of the underlying contract. Thereby any denial of reference at this stage would unnecessarily delay the arbitration. However, the Court has opined that if the award in arbitration was made in favour of the Petitioner, the Respondent would be at liberty to resist enforcement on the ground of subsequent conviction of the officials in criminal proceedings.

ANALYSIS

The judgment provides a much awaited respite to Indian seated arbitrations. In cases of fraud and other malpractices, several arbitrations were stalled due to the objections to arbitrability of allegations of fraud. Parties would renege on their obligation to refer disputes to arbitration with such objections. The decision of the Supreme Court in the *N. Radhakrishnan case* would often be cited in support the defense that claims pertaining to fraud could not be arbitrated.

Now, with this judgment being passed by the Supreme Court, in circumstances where allegations of fraud and other malpractices have been made, the parties would be compelled to go before the arbitral tribunal for resolution of disputes even where the arbitration is seated in India. The judgment further indicates that allegations relating to corruption may also be capable of being decided by arbitral tribunal.

Furthermore, the Court's view that the defense of a contract being void should ordinarily be summarily dismissed brings to fore the pro-arbitration progressive approach of the Indian judiciary. It is appreciable that the Supreme Court has promoted the independent nature of arbitration proceedings and encouraged the courts to merely act as vehicles of support which would aide expeditious arbitrations.

This judgment complements another watershed judgment of the Supreme Court, *World Sport Group (Mauritius) Ltd. v. MSM Satellite (Singapore) Pte. Ltd.*⁹, which was pronounced earlier this year. Thereunder, the allegations of fraud did not prevent the court from referring the parties to a foreign seated arbitration under section 45 of the Act. Thus, the two judgments bring about a uniform positive change in the India arbitration law stance on the issue of arbitrability of the allegations of fraud.

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You can direct your queries or comments to the authors

¹ Arbitration Petition No. 34 of 2013

² (2010) 1 SCC 72

³ For the text of Sections 5, 11 and 16 of the Act please click [here](#)

⁴ *Hindustan Petroleum Corp. Ltd. v. Pinkcity Midway Petroleums*, (2003) 6 SCC 503

⁵ *P. Anand Gajapathi Raju & Ors. v. P.V.G. Raju (Dead) & Ors.* (2000) 4 SCC 539

⁶ For the text of Sections 5, 11 and 16 of the Act please click [here](#)

⁷ For the text of Sections 5, 11 and 16 of the Act please click [here](#)

⁸ AIR 1954 SC 397

⁹ AIR 2014 SC 968; Our analysis of the judgment can be viewed [here](#)

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