

# Dispute Resolution Hotline

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## IS FRAUD OPEN TO ARBITRATION?

Arbitrability of fraud has been one of the contentious issues in arbitration. It involves the question of what type of issues can and cannot be submitted to arbitration. The recent judgment of the Supreme Court, in *A Ayyasamy vs A Paramasivam & Ors*, has settled the law and provides much-needed guidance on this subject.

Earlier, the Supreme Court, in *N Radhakrishnan vs Maestro Engineers*, held that where fraud and serious malpractices are alleged, the matter can only be settled by the court and such a situation cannot be referred to an arbitrator. It was observed that fraud, financial malpractice and collusion are allegations with criminal repercussions, and the arbitrator, being a creature of contract, has limited jurisdiction. It was held that courts are more equipped to adjudicate serious and complex allegations, and are competent in offering a wider range of relief to the parties in dispute.

However, 2014 marked a year of departure, in view of Supreme Court's decision in *Swiss Timing Ltd vs Organising Committee, Commonwealth Games 2010, Delhi*, and *World Sport Group (Mauritius) Ltd vs MSM Satellite (Singapore) Pte Ltd*. These cases held that allegations of fraud were not a bar to refer the parties to a foreign-seated arbitration, and that the only bar to refer parties to a foreign-seated arbitrations are those which are specified in Section 45 of Arbitration and Conciliation Act, 1996. For example, in cases where the arbitration agreement is either (i) null and void; or (ii) inoperative; or (iii) incapable of being performed.

In *World Sport*, the Supreme Court was dealing with an application under Section 45 of the Arbitration and Conciliation Act, 1996. Under Section 45, a party to arbitration agreement can be referred to arbitration unless the arbitration agreement is null and void, inoperative or incapable of being performed, and is applicable only on foreign seated arbitration. Therefore, although the Supreme Court clarified the position of law, at best it could be applied only to foreign-seated arbitrations, which is a niche.

Similarly, in *Swiss Timing*, the Supreme Court dealt with an application under Section 11 of the Arbitration and Conciliation Act, 1996, for appointment of an arbitrator in an international commercial arbitration. Notably, there are many Supreme Court judgments which suggest that under Section 11 the limited scope of enquiry should be confined to existence of a valid arbitration agreement. *Swiss Timing* has been criticised on judicial outreach: (a) decision on arbitrability in a Section 11 application is nothing but a determination on the jurisdiction of the arbitral reference, which otherwise under the principle of competence-competence ought to have been decided by the arbitral tribunal; (b) holding that the ratio of *Radhakrishnan* is per incuriam incorrect as *Radhakrishnan* was decided by a division bench, as against *Swiss Timing* by a single bench; (c) the lack of precedentiary value attached to a decision under Section 11 of the Arbitration and Conciliation Act, 1996. The recent ruling of the Supreme Court in *West Bengal vs Associated Contractors* has held that the decision of the Chief Justice or his designate in a Section 11 application, not being the decision of the Supreme Court or the High Court, as the case may be, has no precedential value, being a decision of a judicial authority which is not a court of record.

The decision of the Supreme Court in *Ayyasamy* has settled the debate; it has been held that: (a) allegations of fraud are arbitrable unless they are serious and complex in nature; (b) unless fraud is alleged against the arbitration agreement, there is no impediment in arbitrability of fraud; (c) the decision in *Swiss Timing* did not overrule *Radhakrishnan*. The judgment differentiates between 'simplicitor fraud' and 'serious fraud', and concludes while 'serious fraud' is best left to be determined by the court, 'simplicitor fraud' can be decided by the arbitral tribunal.

The Supreme Court analysed the category of the rights involved (i.e. 'right in rem—right exercisable against the world at large' and 'right in personam—interest protected solely against specific individuals'). It observed that all disputes relating to right in personam are amenable to arbitration. On the contrary, it was explained that right in rem is required to be adjudicated by courts and public tribunals. The Supreme Court briefly elaborated on the issues which are not arbitrable, including matters involving crimes, matrimony, insolvency, winding up, guardianship, tenancy, testamentary matters (*Booz Allen & Hamilton vs SBI Home Finance*), trusts (*Vimal Kishore Shah vs Jayesh Dinesh Shah*) and consumer protection (*Skypak Courier Ltd vs Tata Chemical Ltd*). More important, the Supreme Court did not include fraud while explaining the issues which are not arbitrable.

This is a landmark judgment and provides much-needed clarity on the subject. But there is a risk for divergent views in differentiating between 'simple' and 'serious fraud', although the Supreme Court has correctly avoided setting out a strict definition of 'serious fraud'. Construction and interpretation of such a term is best left to the discretion of judges who would come to a conclusion depending on the facts and circumstances of a particular case.

This decision will prevent recalcitrant defendant from arguing and delaying arbitral proceedings on the premise that issues of fraud are not arbitrable, and accordingly it is expected that it will help in expediting arbitral proceedings. This is in tune with the pro-arbitration approach adopted by the Supreme Court and various High Courts. This is also consistent with the recent amendments to the Arbitration and Conciliation Act, 1996, and India's approach to revamp

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— **Alipak Banerjee & Vyapak Desai**

You can direct your queries or comments to the authors

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