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Arbitrability of fraud - A quagmire of obscurity

By: Harshita Garg & Medha Priya

ABSTRACT:
In the past, arbitration has evolved as a legal tool that can serve as an alternative to the courts of law to settle issues of law between different parties. While arbitration has its benefits, numerous jurisdictions have narrow the extent to which arbitration can be endorsed to proceed due to the existing laws of a particular state. One of such limitations is the case where allegations of fraud are made to prevent any arbitration proceedings. There has been no clear specific law in the field of arbitration on matters like fraud when alleged by one party on the other. This paper talks about what arbitration means and outlining the scope of arbitrability. It proceeds towards tracing the judicial development on the subject in India under the Arbitration and conciliation act, 1996 and critically analyses the law on arbitrability of claims relating to fraud in India. The chapter concludes by discussing contemporary debates on the arbitrability of fraud through various cases in India.

KEYWORDS: Arbitratability, Arbitration proceedings, Arbitration of fraud, Law, Legal analyses, Disputes.

I. INTRODUCTION:
In the contemporary era of dispute resolution, the expression ‘arbitration’ needs no introduction. It has to turn out to be compatible with dispute resolution for commercial contracts and has been effective in ousting litigation as the favoured method of dispute resolution for commercial disputes. The success of arbitration depends on the mainstays of speed, party dependence and adaptability of proceedings which are the foremost contemplations for 21st-century dispute resolution.

Arbitration and Conciliation Act, 1996 has received the sanction of the President of India on 16th August 1996. This Act has been brought into effect from 25th January 1996, the day the significant Statute was passed. Arbitration is not a novel concept for India. It was prevailing at the Vedic times in India which can be drawn from the Pradvivaca Upanishad. The Arbitration law in India has progressed through the pages of history from time to time. It is constructed on the principle of diminishing the differences or disputes from ordinary courts by mutual understanding or agreement.
of the parties and empowering the parties to transfer to a domestic tribunal entailing of persons of their choice known as arbitrators. They decide the rights and liabilities of parties, in judicial point of views and are binding on them.

In India, the first statutory enactment on arbitration law was the Indian Arbitration Act, 1899, which was based on the English Arbitration Law, 1889. However, this act applied only to those matters which were not before a court of law for adjudication. In 1940, Arbitration law was consolidated and redrafted as the Arbitration Act, 1940. However, due to globalization of trade and commerce, change in world outlook and new challenges facing the modern developing economy of the country, the proposal was tabled by the Law Commission of India, several representative organizations of trade and industry and experts in the area of arbitration came together to amend the Act, to make it more responsive to contemporary requirements.

On 21st June 1985, a Model Law enclosed by the United Nations Commission on International Trade Law (UNCITRAL) for International Commercial Arbitration. It was created to meet the need for harmonising and amend the domestic laws of arbitration in accordance with the various legal systems of the world and therefore includes provisions designed for universal applications. As India is a member-country, it has also adopted UNCITRAL Model law and enacted the Arbitration and Conciliation, 1996, to bring the qualitative changes in the Law of Arbitration. The new law provides for the minimal role of the court during the conduct of arbitral proceedings till the award is made. The Act aimed at introducing basic and qualitative changes in the arbitration practice in India. It provides conciliation as a means of settling commercial disputes.

Almost two decades later, the criticisms reached their peak and India’s reputation to its bottom. With Indian courts being particularly interfering, jurisdiction also comes to the fore in arbitration proceedings sitting outside India. The act required further amendments, classifications and some reforms. Between 2012 to 2019, the Supreme Court taking a needed pro-arbitration advent and delivered various landmark judgements such as declaring the Indian arbitration law as seat-centric; mentioning non-signatories in the arbitration accord to reconcile disputes by arbitration; delineate the extent of public policy in domestic and foreign seated arbitration; and to decide if the simple allegations of fraud are arbitrable.

To amend the law the first attempt was made through the Arbitration and Conciliation (Amendment) Bill, 2003. However, a number of concerns were raised about the proposed

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amendment which led to the withdrawal of the bill from Parliament. On October 23, 2015, the Government of India made major changes to the Arbitration and Conciliation Act, 1996 by introducing the Arbitration and Conciliation Act 2015 (‘Ordinance’) through executive action, intending to expedite the process and reduce court interference. The Arbitration and Conciliation (Amendment Act), 2015 (‘Amendment Act’) was passed by both the Houses of Parliament in the winter session, under which it received the assent of the President on 31st December 2015. The 2015 Amendment Act was well received and expressively enhanced the effectiveness of arbitration in India. The Committee was set up to identify barriers to the development of institutional arbitration and to prepare a roadmap for making India a strong hub for international and domestic arbitration.

The Arbitration and Conciliation (Amendment) Bill, 2018 was put forward and the bill was passed by the Lok Sabha on August 10, 2018, and was pending before the Rajya Sabha. However, the 2018 Bill terminated and did not see the light of the day. Subsequently, the Arbitration and Conciliation (Amendment) Bill, 2019 was introduced on 9th August 2019 as the Arbitration and Conciliation (Amendment) Act and was successfully implemented. The 2019 Amendment Act was passed to make India a centre of institutional arbitration for domestic and international arbitration. Arbitration has evolved as the most preferred form of alternative dispute resolution method, largely due to the rise in commercial disputes. And the intention of the parties to resolve it expeditiously before a private forum. However, it is not immune to the controversial and debatable issues it sees from time to time, which significantly interferes with the judiciary and delays the verdict. One such issue that has plagued arbitration is whether allegations of fraud can be justified under the rule of arbitration. In this research, we shall attempt to present a critical analysis of the existing legal positions on ‘arbitrability of fraud’ in India and how it has evolved throughout various judicial precedents. Also, make an empirical analysis of the Indian Apex Court (Supreme Court of India) decisions as a legitimate question arises whether a civil court can try those cases where the agreement is itself fouled by the components of fraud. This issue has been dealt with broadly by the courts and has been settled, to a certain extent, by the Supreme Court in the case of A. Ayyasamy vs A. Paramasivam. In this article, we shall briefly deal with the cases which spurred the debate over the arbitrability of fraud. Moreover, the strength of the existing legal position and where it is likely to go forward shall be discussed.

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4 (2016) 10 SCC 386
II. ARBITRATION: A BRIEF REVIEW

1. WHAT IS ARBITRATION?

Arbitration is an agreement based form of settlement of an adhesive dispute. Arbitration is a private, judicial resolution of a dispute, by an autonomous third party. In the choice of arbitration, the parties prefer a private dispute resolution process rather than going to court. In other words, the right of a party to refer a dispute to arbitration is based on the existence of an agreement ("arbitration agreement") that can refer the dispute between him and the other parties to the arbitration.\(^5\)

Arbitration is commonly utilized in the settlement of commercial disputes and is unique in relation to mediation and conciliation, which is common in the settlement of labour disputes between both management and labour organizations. Sometimes depicted as a form of alternative dispute resolution. The mediator or conciliator can only suggest the outcomes and both the parties can select whether to acknowledge those proposals. In contrast, arbitration tribunals have the authority to make resolutions that bind the parties.

2. PRIVATE VS. PUBLIC:

Previously, all arbitration was contractual, meaning it was private and voluntary. Recently, a disagreeing kind of arbitration has created, which runs under the direction of the courts, but remains discretionary to the full utilization of the litigation framework. The voluntary form of arbitration is at times called "private" or "commercial" or "contractual" arbitration, and the form related to the court is designated "legal" or “judicial” arbitration.

3. ESSENTIALS OF ARBITRATION AGREEMENT:

The presence of a disagreement is a basic condition for arbitration. Where the parties have adequately settled their disputes, they can't disprove the settlement and appeal to an arbitration clause.

- Result of a meeting of minds:

Consequently, those cases in which neither party had discretion or independence at the moment of termination are excluded.

- Plainly state submission to arbitration:

It ought to obviously emerge from the agreement that the parties consent to go into arbitration.

- Be made among the parties having the legal capacity to submit to arbitration:

According to the law applicable to that question, the parties should be legally entitled to undertake the legal duties.

- Be made by a delegate with power to adhere the principal to arbitration:

Organisations, governments, and other lawful entities may only act in the manner of delegates, and the delegate may require special authorization to bind the principal.

- On paper Agreement:

An arbitration agreement must be recorded as a hard copy. Under Section 7 (4) of the Act, the arbitration agreement is deemed to be in writing, if it contains:

a) A document signed by the parties;

b) A trade of letters, summons, telegrams or other methods for media transmission which deliver a record of the agreement; or

c) A trade of articulations of claim and defence in which the presence of the agreement is asserted by one party and not characterized by another.

- Purpose:

The reason for the parties is of vital significance No form is prescribed for an arbitration agreement and nowhere has it been referenced that conditions like an assertion, authority are fundamental requirements in an arbitration agreement. According to the law of the leading cases in this matter, the intention of the parties to refer their dispute to the arbitrator must be clearly explained by the arbitration agreement.

- Signature:

Arbitration agreements should be endorsed by the parties. The agreement can be in the form of a document signed by both the parties having all the conditions or it can also be a document signed by one party with the terms and an acceptance signed by the other party. It is adequate if one party places his signature in the written proposal and the other party accepts it.

III. **EVOLUTION OF ARBITRABILITY OF FRAUD IN INDIA**

A. **THE EARLIER JUDGEMENTS: DORMANT PERSPECTIVES**

An array of decisions arbitrability of fraud in India took the plunge with the judgment by a three-Judge Bench of the Supreme Court in *Abdul Kadir Shamsuddin Bubere v. Madhav Prabhakar*
The Supreme Court based its decision on various English judgments such as *Russel v. Russel*\(^7\). In which the court held that, in general, the court may refuse to refer a dispute to arbitration on the will of the party but where the objection to arbitration is by the party accusing the fraud, the Court will not necessarily consent to it, and will never do so except a prima facie case of fraud is proved\(^8\).

Following this, the Supreme Court in *Hindustan Petroleum Corp. Ltd. v. Pink City Midway Petroleums*\(^9\) and *P. Anand Gajapathi Raju v. P.V.G. Raju*\(^10\), did not even consider the aspect where a party can switch to any other probable options in the arbitration agreement.

In 2005, the Supreme Court brought about a new officious role in the case of *S.B.P. & Co. v. Patel Engineering*\(^11\). This case established a broader narrative of section 8 of the act. It observed that when there is an arbitration agreement and one of the parties files a suit before a judicial authority notwithstanding the agreement. The other party raises an objection. In such circumstance, the judicial authority has to consider that objection, and if the objection is found worth raised, it shall refer the dispute for arbitration. It is hereby observed that the judicial authority is entitled to, has to and bound to decide the jurisdictional issue before it, before relying upon any reference. Thus, the Supreme Court permitted the court’s intervention while interpreting sec 8 of the Act.

The Supreme Court followed its the previous judgements in the case *N. Radhakrishnan v. Maestro Engineers*\(^12\) and held that whenever serious allegations of fraud are raised, it would infer that they should and must be tried in a court of law and therefore, rejected the application filed under Section 8 of the *Arbitration & Conciliation Act*. This rejection to refer the parties to arbitration changed the course of this issue. The Court in Radhakrishnan likewise overlooked the fact that as opposed to the Arbitration Act, 1940, the outline of reference under Section 8 of Arbitration Act, 1996 was considerably different where reference to arbitration was binding upon the existence of arbitration agreement.

The decision in Radhakrishnan led to arbitration clauses being rendered superfluous and increased the scope for judicial interference.

**B. THE BACK PEDALING FROM:**

**N. RADHAKRISHNAN V. MAESTRO ENGINEERS CASE**

The Radhakrishnan’s judgment was retrieved by the Supreme Court in *Swiss Timing Ltd. v.*

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\(^6\) AIR 1962 SC 406  
\(^7\) Russel, [1880] 14 ch d 471  
\(^8\) AIR 1962 SC 406  
\(^9\) (2003) 6 SCC 503  
\(^10\) (2000) 4 SCC 539  
\(^11\) AIR 2006 SC 450  
\(^12\) (2010) 1 SCC 72
Commonwealth Games Organizing Committee\textsuperscript{13}, and World Sport Group Ltd. v. MSM Satellite (Singapore) Pte Ltd\textsuperscript{14}, where the Court has made audacious and remarkable attempts to rectify the past precedents while dealing with applications filed under Sections 11 and 45 of the Arbitration Act respectively, which were earlier resisted primarily on the grounds of fraud being alleged.

In the Swiss Timing case, where the arbitrator’s appointment under Section 11 was not allowed on grounds of pendency of criminal proceedings thereby nullifying the arbitration clause. The Court appointed the arbitrator in consonance with the spirit of the Arbitration Act. It was held that, when a judicial authority is faced with an arbitration clause in an agreement, it is absolutely compulsory for the authority to refer parties to the arbitration. The Court notably applied the doctrine of severability of the arbitration agreement. The Court also dealt with Radhakrishnan judgment and rightly held the same to be per incuriam. The Court also observed that it is only when the contract is void beyond a reasonable doubt, without the requirement of further proof that the appointment cannot be made under Section 11 of the Arbitration Act. However, as this judgment was made by a Single Judge in an application filed under Section 11, Radhakrishnan judgment could not be overruled in Swiss Timing.

The Supreme Court in World Sport Group was confronted with a comparative inquiry while managing reference to unfamiliar situated arbitration under Section 45 of the Arbitration Act. The Supreme Court not only permitted the application but also went above and beyond and pragmatic that where allegations of fraud in the procurement or performance of a contract are alleged, there is no reason for the arbitral tribunal to decline jurisdiction.

C. THE AYYASAMY CASE: THE DISCERNIBLE EFFECT

Thereafter, in the case of Ayyasamy v. A Paramasivam & Ors\textsuperscript{15}, the Supreme Court made a clear distinction between the simple and complex allegations of fraud in a dispute and ruled that the simple allegations of fraud are arbitral in nature and complex allegation of fraud are not arbitrable.

The two-step test was laid down for the assessment of the degree of fraud and to check whether the allegation is simple or complex in the case of Rashid Raza v. Sadaf Akhtar\textsuperscript{16} case.

i. Does this plea concerns the entire contract and above all, the agreement of arbitration, thereon rendering it void?

ii. Whether the allegations of fraud bring upon the internal affairs of the parties inter se without having any implication in the public domain?\textsuperscript{17}

\textsuperscript{13} (2014) 6 SCC 677
\textsuperscript{14} (2014) 11 SCC 639
\textsuperscript{15} (2016) 10 SCC 386
\textsuperscript{16} Civil Appeal no. 7005 of 2019 ("Order").
\textsuperscript{17} Page 4, Order
It was also stated that the serious assertion of fraud will only be considered if the criminal offence can be ascertained in the mechanism and also the complexity of the dispute should be enough for the extensive proofs in order to make civil proceedings more suitable than the resolution of the dispute through the process of arbitration.

It was deduced that the case of serious allegations of fraud is not supposed to be arbitrated. The Supreme Court in Avitel Post Studioz Ltd. v. HSBC PI Holdings (Mauritius) Ltd. case\textsuperscript{18} focused on determining what would exactly constitute the serious allegations of fraud exemption to the arbitrability of disputes. It had laid down that “serious allegations of fraud” would arise only when either of the following two circumstances is satisfied:

- The first circumstance contains an arbitration agreement that cannot be said to exist. Section 16(1) of the Act provides for a wider interpretation of the arbitration clause includes in itself the arbitration clause shall be treated as an agreement in itself and the invalidity of the contract shall not assume ipso jure the annulment of the arbitration clause. Therefore, through Section 16(1) even when the contract is accepted to be fraudulent, the considerable legitimacy of the arbitration clause is not conceded. The first test read along with Section 16(1) would considerably reduce the scope of judicial intervention on grounds of fraud. The matters in which a party procures an agreement to arbitrate by fraud rarely arise, even in cases where fraud may have been committed in connection with the underlying contract\textsuperscript{19}. This test promotes an internationally accepted approach with minimal intervention by the courts.

- The second circumstance is where allegations of arbitrariness, fraud or mala fide conduct are made against the state or its functionaries. Such cases would defer being arbitrable as they would be related to public law, thereby attracting consequences not only on the parties but concerning the public domain as well. These cases would necessarily be settled in a writ court as issues related to the fundamental rights of the people would arise. However, with regards to fraud underlying the public domain, the Supreme Court stated that allegations of impersonation, false representations and diversion of funds are all internal affairs of the parties having no public texture to it and are therefore not to be assumed as serious allegations of fraud. Therefore, except if these claims are made against the state and its authorities, the dispute would be arbitrable and not be pronounced in court.

\textbf{D. CONTEMPORARY INTERPRETATION}

\textsuperscript{18} Civil Appeal No. 5145 of 2016
Recently in *Vidya Drolia & Others v. Durga Trading Corporation*, the court made an inference that the basis on which fraud was held to be non-arbitrable earlier was that it would contain extensive and lengthy evidence, and thus could be too complicated to be decided through arbitration mode. In present practise, arbitral tribunals are required to devise through volumes of material in various kinds of disputes such as oil, natural gas, construction industry, etc. The ground that charges of fraud are not arbitrable has become an age-old thing and has the right to be disposed of. However, the criminal aspect of fraud or fabrication, which would be visited with penal consequences can be sanctioned only by a court of law, as for it may result in a conviction, which is in the realm of public law.”

**CONCLUSION:**

With an increase in trans-boundary transactions and overt economic policies acting as a catalyst, commercial disputes have been steadily rising. The Indian judiciary has often been carped for an interventionist approach in arbitration, specifically when it ardently involves a foreign party. Some recent judgments of the Indian courts have become a hotbed for controversies and confusion on the law governing arbitration.

Arbitration in India is plagued by irrational delays, exorbitant costs, and unreasonable delay in enforcement of the award. Some have even questioned the very purpose behind enacting the Arbitration and Conciliation Act, 1996 which was to provide for expeditious and effective alternative dispute resolution, now seem to stand frustrated. The confidence and faith of the parties to resolve disputes through arbitration has worn out significantly over time.

After the 2019 amendment act, it was felt that the legislature needs to consider providing upper age limit for any person to be appointed as arbitrator. The prospective of fraud arbitrability also seemed to have a narrow insight. An all-in-all application of the second test of the Avitel case would result in a flood of cases being consigned for adjudication by the courts. This would again lead us back to the initial position of judicial interference by way of closely examining cases involving allegations of fraud to determine arbitrability. Such consequences emerging from this test would thus destabilize the arbitral principles such as kompetenz-kompetenz and also lead to unjustified delays which is contrary to the objectives of the act.

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20 Sayantan Bhattacharyya, Moksh Ranawat, *The arbitrability of civil fraud in India: analysing the Supreme Court of India’s decision in Avitel Post Studios Ltd, Arbitration International* (Nov. 26, 2020); aiaa042.
The judgment thereby could likely save precious judicial time that may otherwise be spent in deciding on the question of arbitrability of a dispute involving allegations of fraud.

The law settled by Courts in India mere allegation of fraud is not sufficient to ignore the arbitration agreement and Courts have to assure themselves whether the case can be decided by way of arbitration or not as per the guidelines provided by the Supreme Court in Ayyasamy case. Furthermore, the criminal cases touching the sustainability of the arbitration agreement have also been reasons for courts in India refusing the reference to arbitration. These approaches of Indian Courts have been restricting the power of the arbitration agreements and proliferating the scope of judicial scrutiny at the time of exercising the powers of the courts under S.8 &11 of the Act, which cannot be claimed to be a provider of better output.

The Lok Sabha has passed the Arbitration and Conciliation (Amendment) Bill, 2021. The Bill intends to replace the Arbitration and Conciliation (Amendment) ordinance issued in November 2020. It provides for checking misuse of the provisions under the Arbitration and Conciliation Act, 1996 which would hereby save the taxpayers money by holding those accountable who siphoned off them unlawfully. All the stakeholders get an opportunity to seek an unconditional stay on the imposition awards of arbitration in which the contract is fraudulent or corruption induced.

However, through the implementation of these legislative changes, the resolution of commercial disputes could take a longer duration from now onwards.

A progressive solution remains hereby on the same foot. The thumb rule for the Court retaining its stand ‘when in doubt, do refer’.