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Dealing with Arbitrability of Fraud in India – The Supreme Court's Fra(e)udian Slip?

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On 4th October, 2016, a Division Bench of the Indian Supreme Court, in *A. Ayyaswamy v. A. Paramasivam* ("Ayyaswamy") [2016], sought to clear the muddied waters surrounding the arbitrability of issues relating to fraud, albeit offering little clarity in the end. The uncertainties regarding arbitrability of fraud claims had previously reached a legal impasse following the contradictory Supreme Court rulings in *N. Radhakrishnan v. Maestro Engineers* ("Radhakrishnan") [2010], and the Single Judge decision in *Swiss Timing v. Organizing Committee, Commonwealth Games 2010* ("Swiss Timing") [2014], and there was onus on the Bench in *Ayyaswamy* to authoritatively rule on the subject.

The SC Division Bench in *Radhakrishnan* had previously held, *inter alia*, that matters of fraud involving complicated questions of law and fact were better suited to be decided by a civil court. However, the Supreme Court in *Swiss Timing*, in a matter under Section 11 of the Arbitration and Conciliation Act, 1996 ("the Act") (relating to appointment of arbitrators), disregarded the ratio of the *Radhakrishnan* case by holding that allegations of fraud may be considered by the arbitral tribunal, in accordance with the powers vested in it under Section 16 of the Act.

The single Judge in *Swiss Timing* also held that the *Radhakrishnan* ruling had not considered all the existing case laws at the time, and was, therefore, *per incuriam*. The direct conflict in the ratios of the *Radhakrishnan* case and the *Swiss Timings* case had led to confusion amongst the lower courts, with many High Courts passing decisions that followed either of the two contradictory cases without offering a reason.

Facts-in-brief and Contentions

In *Ayyaswamy*, the allegations of fraud pertained to the handling of accounts of a hotel by the Appellant. The Respondents, who had entered into a partnership deed for running the hotel with the Appellant, had filed for an injunction before a civil court preventing the latter from managing the affairs of the enterprise.

The Appellant contended that as a valid arbitration agreement existed between the parties, and as per Section 8 of the Act, the matter must be referred to an arbitral tribunal by the civil court. The Appellant also urged the civil court to follow the ratio laid down in the *Swiss Timing* case and thus

hold that the matter was arbitrable. The Respondents argued that the *Radhakrishnan* case clearly mandated that matters of fraud were not arbitrable and that the civil court was the appropriate forum to adjudicate the matter.

Lower Court decisions and Appeal to Supreme Court

The Civil Court decided to follow the ratio of *Radhakrishnan* and dismissed the Appellant's plea for referral of the matter to an arbitral tribunal. The Appellants preferred an appeal before the Madras High Court, which subsequently dismissed the appeal. In its dismissal, the Madras HC reasoned that as the decision in *Swiss Timings* was rendered by a single Judge of the Supreme Court while the decision in *Radhakrishnan* was given by a Division Bench of the Supreme Court, it was bound to follow the judicial precedent set in *Radhakirshnan*. The Appellant then chose to approach the Supreme Court of India for relief.

Decision

The Supreme Court discussed at length the underlying objectives of the Act, observing that the doctrine of separability and *kompetenz-kompetenz* (embodied in Section 16 of the Act) helped the arbitral tribunal retain powers to adjudicate upon matters without court intervention. The SC attempted to strike a balance in the considerations of arbitrability of fraud. It held that while matters that involved allegations of "serious fraud" would not be arbitrable, matters that had "mere allegations" of fraud were arbitrable.

Referring to *Radhakrishnan*, the SC drew contradistinctions between simple allegations and allegations which "demand extensive evidence" and were "complex in nature" – with the latter brought under the ambit of civil courts and *non-arbitrable*. According to the Court, *Swiss Timing* did not have precedential value as opposed to *Radhakrishnan* as they were on varying subject matters.

In the present case, the matter was referred to arbitration as the fraud claims were deemed to be "*were not so serious which cannot be taken care of by the arbitrator*".

Comments and Analysis

The Supreme Court has previously, in *Sukanya Holdings v. Jayesh Pandya* [2003], stated that where both arbitrable and non-arbitrable claims were raised, bifurcation of the subject matter would not be possible. It would, therefore, seem a matter of concern for arbitration in India if claims relating to fraud are raised in order to vitiate arbitral proceedings, as on account of a claim of fraud being raised, all the other substantive issues may also be relegated for adjudication to the civil court.

The 246th Indian Law Commission Report that proposed amendments to the Arbitration & Conciliation Act, 1996 also addressed the issue of arbitrability of fraud. The Report of the Commission notes that it is '*important to set this entire controversy to rest and make issues of*

fraud expressly arbitrable' and proposed in the amendments to Section 16 to confer powers on the arbitral tribunal to deal with serious questions of law, including '*complicated questions of fact or allegations of fraud, corruption, etc.*' It observed that such an amendment was necessary to counter the denudation of the powers of the arbitral tribunal by the Supreme Court. However, the changes proposed by the Law Commission to Section 16 were not effected in the 2015 amendments to the Arbitration Act.

Instead, the amended Section 8 sought to consolidate the *kompetenz-kompetenz* principle by stating that the civil court will refer the parties to arbitration '*unless it finds that* prima facie *no valid arbitration agreement exists*'. The attitude of courts to resort to subject-matter analysis to determine arbitrability is not contemplated, statutorily.

A cause for worry remains the preemptive analysis of merits by civil courts. The Supreme Court, in *Ayyasamy*, reasons that on account of the wording employed in Section 34(2)(b) of the Act (power on civil courts to set aside awards of arbitral tribunals), it is necessary to have laws that state what matters are non-arbitrable as the civil court has powers to set aside an award on the ground that the '*subject matter of the dispute is not capable of settlement by arbitration under the law for the time being in force*'. As the Indian Arbitration and Conciliation Act, 1996, omits to define the contours of arbitrability, this mantle of responsibility has fallen to the decisions of various courts. Civil courts have taken this to mean that they are robed with powers to delve into merits on a case-by-case basis to establish arbitrability of the claims.

The problem is further aggravated by the decision of the Supreme Court in *Ayyaswamy* because it is, in effect, legitimizing the preemptive examination of cases involving allegations of fraud to determine the arbitrability by the lower courts before they refer the matter for arbitration. This would, in addition to disregarding the statutory time frame established by the 2015 Amendments, undoubtedly result in the erosion of the universally recognized principle of *kompetenz-kompetenz* that governs the scope of an arbitral tribunal's powers. This also brings to fore certain problems that may arise: for example, if the court deems a certain fraud claim within the jurisdiction of the tribunal, the tribunal would in effect consider itself to be bound by such a finding.

Thus, the judicial trend to delve into matters of merits does not augur well, especially in light of the courts choosing to flout statutory safeguards attempting to prevent judicial interventionism.

Few comments in India have welcomed the *Ayyaswamy* judgment, stating that the consideration of material evidence and analysis of allegations of fraud for complexity and seriousness by the civil court will yield better results. However, such a view adopts one of two premises – *first*, that the tribunal may elect (wrongly) to adjudicate on matters concerning public policy leading to setting aside of the award by a civil court at a later stage, or, *second*, that the arbitral tribunal is incapable of adjudicating the matter by itself.

We maintain that both of those premises are problematic as they reinforce the protectionist and interventionist attitude that civil courts have been attempting to shed over the past two decades. The Act is clear that the onus to decide on competency to rule on a subject matter rests on the arbitral tribunal – and this must be treated as sacrosanct to avoid decisions along the lines of *Ayyaswamy*. Presently, the silver lining to the *Ayyaswamy* judgment is that it will bring consistency in practice – the courts and lower fora have been supplied a binding decision, but whether this makes up for the usurpation of the tribunal's powers is another matter entirely.

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